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A smarter, softer paternalism is coming into style, but people should still distrust it: leader

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Politics this week

Apr 6th 2006
From The Economist print edition

AP

Thaksin Shinawatra, the Thai prime minister, handsomely won a general election. But the main opposition parties boycotted the poll, and Mr Thaksin's result was worse than at an election a year ago, so he announced that he would stand down. See article

China will close all of its small coal mines by the end of next year in an attempt to improve the industry's dismal safety record.

Pakistani security forces killed at least 16 Taliban militants in a clash near the Afghan border, in war-racked North Waziristan.

The **Nepalese** government rejected an offer by Maoist militants for an indefinite ceasefire in the area around the capital, Kathmandu. The opposition began a four-day strike.

The Hammer comes down

Tom DeLay, the former House majority leader, said he was resigning from Congress. Affectionately known as “the Hammer” in his heyday, Mr DeLay gave up the leadership post to fight charges of campaign-finance wrongdoing. See article

The **Massachusetts** legislature overwhelmingly passed a comprehensive health-insurance programme that will eventually cover around 95% of uninsured people in the state. The bill's supporters are pushing it as a model for the federal government. See article

Two federal **air marshals** pleaded guilty of planning to smuggle cocaine on a flight from Houston to Las Vegas. The pair, arrested in a sting operation in February, were hired after the expansion in airline security following the September 11th attacks.

It all catches up, eventually

Saddam Hussein is to be tried on new charges of genocide against Iraq's Kurds in the 1980s. On some estimates more than 100,000 were killed, some of them by poisonous gas in the infamous Anfal campaign in 1988. Under cross-examination for the first time in his current trial, the former Iraqi dictator admitted signing an order for the execution of 148 Shias.

Condoleezza Rice, America's secretary of state, and Jack Straw, her British counterpart, made a surprise visit to **Iraq** to hurry along the formation of a new government. Ibrahim al-Jaffari reiterated that he would not resign as prime minister, despite calls for him to go. See article

The UN rushed aid to **Iran**'s western Lorestan province where a series of earthquakes killed 70, injured at least 1,300 and left thousands without homes.

In **Kuwait**, women voted for the first time after being granted equal political rights last year. They participated in a council by-election in a district south of Kuwait City.

EPA

Sudan banned Jan Egeland, head of the **UN**'s emergency relief operations, from entering the conflict-torn region of **Darfur**, but then relented under international pressure. Separately, the African Union announced an investigation into claims that its peacekeepers in the region committed sexual abuse.

Charles Taylor, former Liberian president, was charged with crimes against humanity in the international war-crimes tribunal in Sierra Leone. To avoid risk of destabilising the region, his trial may be transferred to The Hague. Sweden said it might be prepared to take him as a prisoner, if he is convicted. See article

As registration for candidates in **Congo**'s first multi-party elections in 40 years closed, the Union for Democracy and Social Progress, led by a veteran opposition leader, Etienne Tshisekedi, announced it would boycott the poll. More than 70 people have signed up for the presidential contest, including the incumbent, Joseph Kabila.

Uganda's opposition leader, Kizza Besigye denied treason charges at the start of his trial in Kampala. The Supreme Court rejected his challenge to presidential elections, won in February by Yoweri Museveni for a third term.

Setting the world on fire

In an unusually brief “throne speech” at the start of a parliamentary session, **Canada's** new Conservative minority government promised measures to fulfil campaign promises, such as an accountable-government bill and a cut in sales tax, but otherwise gave little away. See article

Ralph Klein, the long-serving Conservative premier of oil-rich **Alberta**, Canada's fastest-growing province, received an unexpected snub when only 55% of delegates at a party convention endorsed his leadership. As a result, Mr Klein said he would step down at the end of this year, rather than in 2008. See article

Venezuela's government took control of two oilfields, one operated by France's Total and the other by Eni of Italy, after the companies refused to sign up to new arrangements converting their operating contracts into joint ventures in which Petróleos de Venezuela, the state oil firm, will have a majority stake. Exxon Mobil earlier sold a stake in a small field to Spain's Repsol to avoid the change. See article

A dented reputation

There were further **protests in France**, even after President Jacques Chirac promised to water down the new job-contract for young people. The protesters are insisting on its withdrawal. Mr Chirac gave the task of reshaping the law to parliament, not to the prime minister, Dominique de Villepin, severely weakening the latter's authority. See article

Getty Images

Italy staged its second TV debate between the two main candidates for prime minister in next week's election. Silvio Berlusconi, the incumbent, surprised his centre-left opponent, Romano Prodi, by offering some new tax cuts. Most pundits judged the debate a draw, but still expect Mr Prodi to win the election narrowly. See article

Denis Donaldson, a one-time senior man in **Sinn Fein** who admitted to having been a British agent for 20 years, was shot dead in a cottage in Co. Donegal, Ireland. Sinn Fein's paramilitary wing, the IRA, denied responsibility. See article

Serbia has assured the International Criminal Tribunal for ex-Yugoslavia in The Hague that it will hand over **Ratko Mladic**, the Bosnian-Serb general accused of genocide, by the end of April.

Gazprom, Russia's state-run gas giant, said it was planning to raise sharply the prices it charges to **Belarus**, whose economy depends on cheap Russian gas. The move was seen as part of Gazprom's bid to take control of Belarus's pipelines.

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Business this week

Apr 6th 2006
From The Economist print edition

Five years after walking away from a previous agreement, **Alcatel**, based in Paris, and **Lucent**, based in New Jersey, said they will merge to create a network-equipment manufacturer rivalling Cisco Systems in size. To head off political misgivings about the deal, Alcatel is selling its satellite business to **Thales**, a French defence group; to handle government research projects in the United States, the newly combined company will create a subsidiary overseen by a board of former American security officials. See article

Apple Computer released software that allows its latest Macintosh computers, based on Intel chips, to run Microsoft Windows in addition to Apple's own operating system, Mac OSX. Its share price surged on the news.

Selling the family silver

After arduous negotiations, **General Motors** announced it was selling a 51% stake in **GMAC**, its mortgage and financial services business (and most profitable division), to a group of private investors for $14 billion. However, the carmaker's share price fell after sales data showed it was losing yet more market share. See article

Further trouble for GM loomed on the horizon as **Delphi**, its main parts supplier, filed a restructuring plan that sheds most of its factories, eliminates thousands of jobs and voids the contracts and benefits of its current and retired workers. Unions warned that they were ready for a prolonged strike if the plan is approved; credit-rating agencies said such a strike would only entrench GM's “junk” status. See article

Continental, a German tyre and car-parts firm, agreed to buy **Motorola's** telematics (car navigation and communications) division for $1 billion. The division supplies electronics to carmakers in North America and is a new venture for Continental, which has also expressed an interest in buying bits of Delphi.

Rolf Breuer announced his resignation as chairman of **Deutsche Bank's** supervisory board. He is stepping down to spare Germany's biggest bank embarrassment that might stem from a lawsuit filed by Leo Kirch, in which the tycoon blames Mr Breuer for the fall of his media empire following negative remarks he made in 2002 regarding Mr Kirch's creditworthiness.

Poland reached an agreement with **UniCredit** that will allow the Italian bank to complete its takeover of Germany's HVB, (which involves two Polish banks). Poland's refusal to allow the deal had drawn sharp criticism from the EU, which accused its prime minister of acting like an economic nationalist.

Australia's financial regulator accused **Citigroup** of insider trading during a large takeover last year in which it was an adviser. Separately, the Federal Reserve Bank of New York ended a year-long ban on Citigroup from conducting big acquisitions. The punishment was handed down by the

Fed after the financial services group became embroiled in a series of regulatory problems. See article

Lloyd's reported a small pre-tax loss of £103m ($187m) for 2005, its first loss in four years. The world's oldest insurance market was hit by record claims, mostly stemming from last year's hurricane season.

Strategic steel stitching-up

Arcelor transferred its recently acquired holdings in **Dofasco**, a Canadian steelmaker, to a Dutch foundation so as to bolster its defences against **Mittal Steel's** hostile takeover plans, which include selling Dofasco. The move angered some of Arcelor's shareholders (even though the firm also increased its dividend by 54% above that announced in February) who complained about the lack of consultation.

International Paper agreed to sell 5.1m acres of forest, dotted around the United States, to investors for $6.1 billion. That brings the total disposals of the firm to 5.4m acres, believed to be America's biggest-ever private sale of forest.

Netflix, which pioneered online DVD rentals, launched a lawsuit against **Blockbuster**, accusing its rival of infringing two patents relating to its business methods in the United States. Blockbuster, responding to Netflix's growing popularity, launched its own online service 20 months ago.

Coca-Cola overhauled its pay for directors and linked their cashing-in of share grants to the future performance of the company. The move had been championed by Warren Buffett, who leaves Coca-Cola's board on April 19th.

The work ethic

More data pointed to evidence of **Japan's** economic recovery. Its unemployment rate fell to 4.1% in February, the lowest in almost eight years, while the ratio of jobs to applicants reached a 14-year high. The news suggests that interest rates will rise above zero sooner than expected.

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Soft paternalism

The state is looking after you

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From The Economist print edition

A new breed of paternalists is seeking to promote virtue and wisdom by default. Be wary

LIBERALS sometimes dream of a night-watchman state, securing property and person, but no more. They fret that societies have instead submitted to the nanny state, a protective but intrusive matriarch, coddling citizens for their own good. Economists, with their strong faith in rationality and liberty, have tended to agree. As many decisions as possible should be left in the individual's lap, because no one knows your interests better than you do. Most of us have gained from this freedom.

But a new breed of policy wonk is having second thoughts. On some of the biggest decisions in their lives, people succumb to inertia, ignorance or irresolution. Their private failings—obesity, smoking, boozing, profligacy—are now big political questions. And the wonks think they have an ingenious new answer—a guiding but not illiberal state.

What they propose is “soft paternalism” (see article). Thanks to years of patient observation of people's behaviour, they have come to understand your weaknesses and blindspots better than you might know them yourself. Now they hope to turn them to your advantage. They are paternalists, because they want to help you make the choices you would make for yourself—if only you had the strength of will and the sharpness of mind. But unlike “hard” paternalists, who ban some things and mandate others, the softer kind aim only to skew your decisions, without infringing greatly on your freedom of choice. Technocrats, itching to perfect society, find it irresistible. What should the supposed beneficiaries think?

Choosing not to choose

Most people would accept that a healthy diet is hard to achieve, financial matters are confusing and cigarettes kill too many. The state is tempted to step in, not only because of the harm that smokers, lushes, spendthrifts and gluttons may do to others, but because of the harm they are doing to themselves. In Scotland last month the government banned smoking in offices, restaurants and pubs. In Massachusetts, the state legislature has passed a bill requiring everyone who can afford to buy health insurance to do so, on pain of higher taxes.

This is hard paternalism. The softer sort is about nudging people to do things that are in their best interests. The purest form involves setting up systems for sinners to reform themselves: in Missouri for instance, some 10,000 compulsive gamblers have banned themselves from riverboat casinos; if they succumb to their habit (and are caught) they face tough punishments. In most cases, though, soft paternalism means the government giving people a choice, but skewing the choice towards the one their better selves would like to make.

For instance, in many countries plenty of workers fail to enrol in pension schemes and suffer as a result. The reason is not that they have decided against joining, but that they haven't decided at all—and enrolling is cumbersome. So why not make enrolling in the scheme the default option, still leaving them the choice to opt out? Studies have shown this can nearly double the enrolment rate. Lord Turner, head of Britain's Pensions Commission, is the latest soft paternalist to recommend such a scheme (see article).

Soft paternalists also want to give people more room to rethink “hot and hasty” decisions. They favour cooling-off periods before big decisions, such as marriage, divorce or even buying cigarettes. Some of them toy with elaborate “sin licences”, which would entitle the holder to buy cigarettes, alcohol or even perhaps fatty foods, but only at times and in amounts the licenceholder himself signed up to in advance.

If people want this kind of customised paternalism, why can't the market, in the shape of rehab clinics and personal trainers, provide it? Soft paternalists argue that, without the power of the state behind such schemes, they will often break down: the sovereign consumer can always veto his own decisions. He can fire his personal trainer or check out of the clinic. Long before the government took it upon itself to ban opium from general sale, Samuel Taylor Coleridge, a Romantic poet and drug addict, used to hire porters to bar his entry to apothecaries. But he would later threaten to have them arrested if they did not let him pass.

Letting the mice play

Soft paternalism has much in its favour. First, it is certainly better than hard paternalism. Second, a government has to provide information to citizens in order for them to make rational decisions on everything from smoking to breastfeeding to organ donation. Even a government reluctant to second-guess its citizens ends up advising them in one way or another. What people decide they want is often a product of the way a choice is framed for them—they take the first thing on the menu, or a bit of everything. Even a truly liberal government would find itself shaping the wishes and choices to which it earnestly wants to defer. It's surely better to lure people into pension schemes than out of them.

Yet from the point of view of liberty, there is a serious danger of overreach, and therefore grounds for caution. Politicians, after all, are hardly strangers to the art of framing the public's choices and rigging its decisions for partisan ends. And what is to stop lobbyists, axe-grinders and busybodies of all kinds hijacking the whole effort? There is, admittedly, a safety valve. People remain free to reject the choices soft paternalism tries to guide them into—that is what is distinctive about it. But though people will still have this freedom, most won't bother to use it—that is what makes soft paternalism work. For all its potential, and its advantage over paternalism of the hard sort, this is

a tool that transfers power from the individual to the state, which only sometimes knows best.

Its champions will say that soft paternalism should only be used for ends that are unarguably good: on the side of sobriety, prudence and restraint. But private virtues such as these are as likely to wither as to flourish when public bodies take charge of them. And life would be duller if every reckless spirit could outsource self-discipline to the state. Had the government deprived Coleridge of opium, he might have been happier. Then again, there might have been no “Kubla Khan”.

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Italy's election

Basta, Berlusconi

Apr 6th 2006
From The Economist print edition

Italians have a rotten choice to make, but it is time to sack Silvio Berlusconi

Corbis

FIVE years ago, this newspaper declared that Silvio Berlusconi was unfit to lead Italy. Mr Berlusconi was (as he still is) the head of Forza Italia, a political party that he had created only seven years earlier, and as such he was the centre-right's candidate to become prime minister. Despite our declaration, Italians voted his coalition into power in May 2001—and Mr Berlusconi has been Italy's prime minister ever since. Now, in the election on April 9th and 10th, he is seeking a fresh term of office. He does not deserve one.

Our verdict against Mr Berlusconi in 2001 rested on two broad considerations. The first was the glaring conflict of interest created by his ownership, via his biggest company, Mediaset, of the three main private television stations in Italy. The second was the morass of legal cases and investigations against him and his associates for a wide variety of alleged offences, ranging from money-laundering and dealing with the Mafia to false accounting and the bribing of judges. We concluded that no businessman with such a background was fit to lead one of the world's richest democracies.

That view stands: we continue to think that Mr Berlusconi is unfit to be prime minister, both because of the conflict of interest arising from his media assets and because of his continuing legal travails (he may shortly go on trial yet again for alleged bribery, this time of a British witness, David Mills, who happens to be married to a minister in Tony Blair's cabinet, Tessa Jowell). But five years on we have a new and even more devastating reason to call for Mr Berlusconi's removal from office: his record in power.

As we predicted in 2001, his premiership has been disfigured by repeated attempts, including an avalanche of new laws, to help him avoid conviction in legal trials. He has devoted much time not

only to changing the law to benefit himself and his friends, but also to besmirching Italy's prosecutors and judges, undermining the credibility of the country's entire judicial system. It is not surprising that tax evasion, illegal building and corruption all seem to have increased over the past five years. And, again as we predicted, he has done little to resolve his conflicts of interest: instead, he has shamelessly exploited the government's control of the state-owned RAI television network. Directly or indirectly, Mr Berlusconi now wields influence over some 90% of Italy's broadcast media, a situation that no serious democracy should tolerate.

The failed reformer

Italian voters knew most of this in 2001, of course. Yet they still chose to give Mr Berlusconi their backing, for quite another reason. They hoped that he would deploy the business skills that had helped to make him so rich to reform their weak economy, making all Italians richer as well.

On this count, however, Mr Berlusconi's government must be judged an abject failure (see article and article). Italy now has the slowest-growing large economy in Europe. With wages still rising even though productivity is not, and with currency devaluation no longer possible now that Italy is in the euro, Italian business is fast losing competitiveness. Many of the country's traditional producers in such industries as textiles, shoes and white goods are under devastating attack from lower-cost Chinese competitors. The Berlusconi government has also undone much of the improvement to the public finances made by its predecessor: the budget deficit and the public debt, the world's third-biggest, are both rising once more.

It would be unfair to assert that Italy's economic difficulties are all Mr Berlusconi's fault. In truth, its problems are similar to most of Europe's, although they seem worse in Italy than anywhere else. As in France and Germany, their roots stretch back for decades, not years. To cure them will require the adoption of many tough reforms; and, as France has just demonstrated so graphically, implementing such changes is politically challenging, to say the least. But where the Berlusconi government has really let Italy down is in failing even to begin the process. Apart from a few sensible labour-market and pension reforms, it has done too little to press ahead with market liberalisation, with more privatisation and with the promotion of competition in what is one of Europe's most overregulated economies. The conclusion from these five years is that Mr Berlusconi is not and never will be a bold economic reformer of the kind that Italy desperately needs.

Prodi's test

Unfortunately there are reasons to doubt whether his centre-left opponent, Romano Prodi, would be a lot better. The former economics professor grasps the need for change in Italy more clearly than Mr Berlusconi, who has spent much of the campaign denying that the country has any economic problems at all. Moreover, Mr Prodi made a fair stab at initiating reforms when he was prime minister in 1996-98—and he also succeeded in getting the country into the euro. But neither then nor in his later stint as president of the European Commission did he show himself to be a forceful leader, still less an unwavering advocate of economic liberalism. Most worrying of all, if Mr Prodi wins the election he seems certain to be dependent on the support of coalition partners who are actively hostile to reform, particularly the unreformed Communists who are led by Fausto Bertinotti.

In foreign policy, too, some of Mr Prodi's instincts may be unwelcome. He is a faithful believer in a European federal superstate; Mr Berlusconi's more sceptical approach to Brussels is one of his better points. Mr Prodi's plans to withdraw Italian troops from Iraq are no longer controversial—indeed, there is little difference between him and Mr Berlusconi on this issue—but he is likely in

general to adopt a rather less friendly attitude to America than his rival.

It is the economy that will remain the critical test. Sadly, most Italian people do not yet recognise how sick their economy has become. For that reason they may not be ready for the pain of reform. Mr Berlusconi is certainly not going to push them—and he remains unfit for the office in any event. Italians should accordingly vote for Mr Prodi, not *il Cavaliere*.

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Thailand

A blow to Thai democracy

Apr 6th 2006
From The Economist print edition

The mob has beaten the ballot box in South-East Asia

EPA

"IT'S a funny old world," Margaret Thatcher remarked as she was driven from power in 1990, not by the electorate but by her own party. Like Mrs Thatcher, Thaksin Shinawatra, the prime minister of Thailand since 2001, has won three elections on the trot. But that has not stopped him, like her, from making a tearful early exit from office.

Mr Thaksin won his most recent victory on April 2nd (see article). Because all the main opposition parties had boycotted the poll, this was a foregone conclusion. Since the boycott turned this into more of a referendum than an election, the prime minister had vowed to quit if he did not win more than 50% of the vote. Despite a campaign by the boycotters to have their supporters register a "no vote", he scored around 57%. However, partly because of a relatively poor turnout, he won 3m fewer votes than he had a year ago—resulting in less than the ringing re-endorsement he had hoped for. And the opposition, despite having in effect scored a third consecutive defeat, vowed to continue its clamorous street rallies against him, disrupting traffic and government business in Bangkok. It all proved too much. After an audience with the king, Mr Thaksin announced on April 4th that he would go.

Many people will call this a great day for Asian democracy. Mr Thaksin is an unattractive figure, a billionaire who spent his way to power by setting up his own lavishly funded party, and relentlessly promoting it using the stable of media companies he had conveniently acquired. This route to power echoed that taken by Italy's Silvio Berlusconi (see article), who faces his own difficult encounter with the voters this weekend. And the criticisms of both men are strikingly similar: that their great wealth creates many conflicts of interest; that they have ridden roughshod over their countries' constitutions; that they have attempted to suppress criticism; and that they have both, in different ways, been disappointments in office, despite billing themselves as high-powered business types who know how to get things done. Both men, in short, have been bad for

democracy, and both their countries will be better off without them.

The shadow of the barracks

At this point, nonetheless, the two stories diverge. If Mr Berlusconi wins 57% of the vote in Italy's election, nobody expects to see Romano Prodi and the opposition he leads taking to the streets, camping out at the Quirinale, shutting down the Piazza Navona and vowing not to rest until they have driven the prime minister from power. The world would rightly condemn them in the unlikely event that they did so. In Thailand, while Mr Thaksin is undoubtedly a disease in the body politic, the cure that has just been applied is worse than the illness itself. It is not yet clear exactly why Mr Thaksin resigned, despite his victory. But the fear of mob violence, or the growing possibility of military intervention, or pressure from an extremely powerful royal palace may all have played their part. And none of these is healthy for a country that aspires to be a true democracy.

For all his many faults, Mr Thaksin deserves some credit for introducing a bold new concept into politics—that government should pay much more attention to the wishes of those left behind by the economic boom in Thailand's poorest rural provinces (most of which voted, enthusiastically, for him on April 2nd). This principle has borne fruit politically, and economically too. It has helped pump up domestic demand, something a country such as Thailand, which has faced devastating competition from China in the export market, badly needs. The policy has proved so successful that other countries in the region have openly copied it.

Beyond this, the political system in Thailand was not as badly broken as Mr Thaksin's opponents have often claimed. If it were, he would not have had to sell almost all of his family's assets in January, including the television station that is supposed to have been so central to his power. That sale made the most recent election at least reasonably free and fair. Newspapers, in particular, were much more critical of Mr Thaksin than in the past. It is a great pity that the mob was in the end allowed to beat the electoral system. The correct way to oust Mr Thaksin should have been at the ballot box.

Now fix the damage

Much of East Asia has only recently emerged from the shadow of the barracks, and a young democracy is one that cannot be taken for granted. The spectacle of an urban elite overthrowing an elected leader, one who enjoyed great popularity among the rural poor whom he genuinely helped, is not only distasteful but potentially dangerous. The nearest parallel is probably the Philippines, where an urban revolution, backed by the army, drove the populist and utterly useless president, Joseph Estrada, from office in 2002. Gloria Macapagal Arroyo, who inherited his job, also inherited a country addicted to actual and attempted revolution—“people power” as it is sometimes too flatteringly called. If Thailand slips into a similar cycle of instability, one might start to worry about the future of far more fragile Indonesia as well.

With luck, it will not come to that. Thailand's “revolution” was well-behaved and bloodless. Bangkok's middle class may be too sensible to be easily drawn further down the path that can lead to coups. Its own bloody experience of military crackdowns, in 1973 and 1992, is still fresh.

With the “dictator” now off the scene (for the moment, his deputy is to become prime minister), can Thailand once again become a model transitional democracy? This will require maturity from both sides. Mr Thaksin must avoid interfering. And the opposition must now speedily return to democratic methods. The present parliament, with the main opposition parties absent, is an aberration that ought not be allowed to last more than a few weeks. New elections will have to be

held and it is essential that all the main parties contest them. If, as seems possible, Mr Thaksin's party, Thai Rak Thai, emerges on top again and is able to form a government, the opposition must accept the result. That's how democracy should work.

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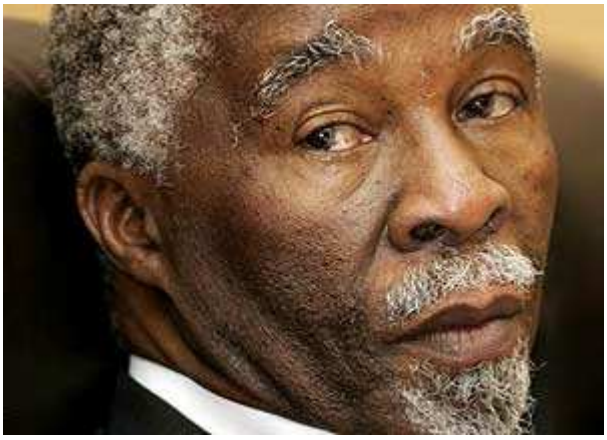
Term limits in Africa

When enough is enough

Apr 6th 2006
From The Economist print edition

Too many of Africa's "big men" outstay their welcome

AP



THABO MBEKI, South Africa's president, has had a mixed record during his seven years in power (see article). But perhaps the best thing he has done for Africa is to declare that he will call it a day after his second term in office, as the constitution requires, and not seek re-election in 2009. His predecessor, Nelson Mandela, resigned after just one term, in 1999, and now lives in saintly retirement.

For many other African leaders, unfortunately, staying in power becomes an all-consuming passion, always to the detriment of their own country and people. That has been true of Robert Mugabe in Zimbabwe for some time, of course. But with the emergence of a new generation of leaders in the 1990s, as part of what Mr Mbeki himself dubbed the "African renaissance", it was hoped that the introduction of new constitutions with two-term limits on power would consign the "big man" syndrome of African politics to history.

It has worked in South Africa and Tanzania. But in too many countries term limits are failing to block the vaulting egos of leaders determined to cling on. Yoweri Museveni has just won a third term as Uganda's president by using his huge majority in parliament to push through a constitutional amendment letting him run again. More worryingly, it looks as if Olusegun Obasanjo, a mild success by Nigeria's kleptocratic standards, may try to do the same in Africa's most populous country. This prospect is already adding to instability. Militants in the River Niger delta, seeking more of the money flowing from the oil wells there, have stepped up their campaign of kidnapping foreign workers and attacking oil installations. Violence between Muslims and Christians is rising.

Just as Mr Museveni did in Uganda, Mr Obasanjo is beginning to crack down on the opposition—in

his case, it seems, by using the government's vaunted anti-corruption drive to knock opposition leaders out of contention. Worse, many now suspect that Mr Obasanjo is fomenting some of the instability so that, having got the constitution changed, he can then pose as a strong man in next year's presidential election, securing his third term as the saviour of a disintegrating country. For would-be dictators, this is the oldest ruse in the book.

Term limits certainly place a restriction on democratic choice, which is one reason why they are unwelcome in America's state legislatures. But even the United States, whose system of checks and balances on the executive is considerably more robust than Nigeria's, has been cautious about granting too much power to the big man: presidents have been limited to two terms since 1951. Several Latin American countries have swallowed their previous doubts and allowed incumbent presidents to seek a second—but not a third—consecutive term (usually with poor results). In countries where institutional restraints on executive power are often weak, the risk is high that even leaders who start out well end up undermining democracy by staying on too long.

Mr Mbeki likes to practise what he calls “quiet diplomacy”. He has failed dismally in the case of Zimbabwe, but did help to talk Frederick Chiluba into standing down when he became a liability to Zambia. Now would be a good time to take Mr Obasanjo aside for a friendly chat on the virtues of term limits. For the good of Nigeria and of Africa, Mr Obasanjo should be persuaded to honour his own constitution and go.

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Mergers and acquisitions

Riding a wave

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From The Economist print edition

Deals are getting bigger and, it appears, slightly better

TODAY'S wave of mergers is cresting peaks reached only at the turn of the century, at the height of the dotcom bubble. The value of European companies acquired in the first three months of this year was almost 130% greater than in the same period a year ago. Even in the United States, where dealmakers have for longer been exploiting cheap capital, the value of deals was up on the same (very high) levels of a year earlier. Is this boom, like the dotcom one before it, bound to turn to bust?

The failure of some of the biggest deals in the past to deliver their promised rewards has underpinned the popular idea that M&A is a mug's game. Plenty of research has shown that most deals fail to create value for the acquirer's shareholders. However, today a growing body of evidence suggests that the continuing appetite for M&A can make sense. Not every deal will come off, to be sure; but it is easier to recognise those that stand a decent chance of success.

Deal design

In this wave of mergers, deals are getting bigger. In the first quarter, Europe saw nine valued at more than $10 billion, as many as during the three full years from 2002-04. Deals of that size are cropping up in the United States with increasing frequency too. This week alone saw the $13.4 billion takeover of Lucent Technologies by Alcatel (see article) and the $14 billion sale of a controlling stake in GMAC, General Motors' financial arm. Big deals are harder to execute than smaller ones, partly because their scale almost inevitably makes them more complex, but partly also because the cultures of the participants are more deeply embedded and more resistant to change, a particularly important factor at a time when more deals are hostile (see article).

The stakes have been raised by private-equity firms, which are competing with corporate buyers, pushing up prices and borrowing heavily. Yet that is one reason to be more optimistic about their outcome. For private equity possesses one trait that the Boston Consulting Group recently identified as an ingredient of success: technique. There is, says the firm, “a clear and replicable method in the apparent madness of the most successful serial acquirers.” Such an approach is open to companies, too. Cisco and General Electric (see article) have demonstrated that it is possible to learn how to take over others, partly by planning the integration of each new acquisition well in advance. At the least, practice makes less imperfect.

What about firms that only want to make an occasional purchase? It is a good sign if they are paying in cash not shares; as private-equity firms have shown, debt concentrates the mind wonderfully. Another horse to back is consolidation. Peter Drucker once warned that “the

symphony orchestra does not attempt to cure the sick...diversification destroys the performance" of an organisation.

Grand designs that posit synergies to be gained from combining disparate businesses frequently fail. So be sceptical about AT&T's deal with BellSouth, based on the unproven assumption that consumers will want to buy several communications services from a single supplier. But welcome down-to-earth deals that are consolidating industries across a larger geographical arena—such as Mittal Steel's hostile $24 billion bid for Arcelor, another steelmaker.

Before the rejoicing gets out of hand, though, remember that consolidation has its limits. There is every chance that today's optimism will eventually fall victim to overstretched finances or a recurrence of managerial over-confidence. The danger of delusion is never far away. As a recent article by consultants at McKinsey puts it: "almost all of us believe ourselves to be in the top 20% of the population when it comes to driving, pleasing a partner, or managing a business."

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Current-account deficits

Still waiting for the big one

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Today Iceland and New Zealand. Tomorrow the United States?

ICELAND is famous for its geysers, which periodically erupt, violently ejecting a column of boiling water and steam high into the air. How apt that Iceland could be an early warning of a global financial eruption as investors turn more risk averse. Over the past month Iceland's currency and stockmarket have fallen sharply; its banks have struggled to roll over short-term debt. Iceland's massive current-account deficit of 16% of GDP makes this tiny economy an extreme case, but it is not alone: New Zealand, Australia, Turkey and Hungary have also seen their currencies fall. Are these the local difficulties of a few small economies or a foretaste of the fate awaiting America?

These besieged currencies have something in common. Their economies all have big current-account deficits, driven in large part by rapid growth in consumer spending on the back of asset and credit booms. Recent events are thus an alert to larger countries with similar symptoms, not least America.

The liberalisation and expansion of global capital markets was supposed to impose discipline on countries' economic policies, by punishing the profligate and rewarding the prudent. A rising current-account deficit should cause investors to demand higher interest rates to offset the risk of currency depreciation. In turn, higher rates should prompt governments and consumers to tighten their belts, helping to shrink external deficits. A decade ago, countries with large current-account deficits did indeed face much higher real bond yields. But in recent years interest-rate differentials have narrowed. Financial markets have become poor disciplinarians.

When average interest rates in the developed world fell to a record low earlier this decade, investors wanted extra yields. They took bigger risks, dragging down risk premiums. Cheap money attracted capital into “carry trades”, where investors borrow short-term at low rates to invest in riskier, higher-yielding bonds, such as those issued by Iceland and New Zealand—or the American Treasury. By underpricing risk, investors have, in effect, subsidised extravagant borrowers, letting them run ever bigger deficits. A correction may be under way.

Beyond the fringe

America has found it easy to finance its $800 billion current-account deficit in an era of lax money. But for the first time in many years the big central banks in America, Japan and the euro zone are all now draining liquidity from the financial system. Dearer money is encouraging investors to discriminate again, putting some fringe markets under pressure. Could this herald a wider flight from risk?

The dollar is still supported by large purchases of dollar reserve assets by China and the oil-producing nations. But for how long? Although the dollar is the world's main reserve currency, increasing nervousness about America's external deficit and fears of a tumbling currency would create a strong incentive to move out of dollars, with serious consequences for bond yields, house prices and the currency itself.

As yet, the greenback is little affected by Iceland and New Zealand—and not only because they are small. Money is still cheap. The Bank of Japan has ended its “quantitative easing”, but interest rates are still zero. America's bond markets have gained most from the yen carry trade (borrowing in cheap yen to buy American T-bonds), so future increases in Japanese interest rates will spur investors to ask if historically low yields still compensate for the risk of holding dollar assets. This week ten-year T-bonds were nudging 4.9%, up from 4.4% in January.

Iceland and New Zealand could be warning that countries with big external deficits are vulnerable. America's reserve-currency status makes it likely to be the last to blow, so its deficit may continue to grow. But those studying geysers know that the longer pressure builds, the bigger the eruption.

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On Chicago, oil, open-source knowledge, Israel and the Palestinians, potatoes, Charles Taylor, rights, left-handed snails

Apr 6th 2006
From The Economist print edition

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Charter for success?

SIR – Your survey of Chicago mentions that charter schools are improving the city's education system and alludes to the idea that handing principals full control over enrolment will improve schools (March 18th). For whom? The school system cannot be said to have truly improved if the students most in need of improvement have been flushed out. What becomes of students who are "undesirable" in most principals' eyes?

The high-school children I teach range from super-achievers to "flunkies" who barely scrape by. I'll be the first to admit that the flunkies are not my favourites, but someone should have the duty to see they are given an education. If my principal was given the power to remove these kids, where would they go? They would lose any positive interaction with fellow students (and super-achievers would become completely disconnected from the less fortunate). Charter schools present many opportunities, but they are not a worthy alternative until they accept that all young people deserve access to education. Furthermore, their paltry pay will do little to attract teachers who are the best and the brightest.

Ross Freshwater
Chicago

SIR – You think the Cabrini Green housing project has gone? I was mugged walking past its main building just over three weeks ago. Believe me, it's still there.

Steve Simko
Chicago

A new dawn

SIR – The Saudis may well be able to pump oil from out of the ground at less than a dollar per barrel (Face value, March 25th). But they will only drop the current price of $60 a barrel in order to knock out biofuel alternatives. Perhaps the world does need a disruption to Saudi supplies that will shake our addiction to oil. As Sheikh Zaki Yamani, a former Saudi oil minister, quoted by yourselves once said "The Stone Age did not end for lack of stone, and the Oil Age will end long before the world runs out of oil" ("The end of the Oil Age", October 25th 2003).

Alan Sealey
Winsley, Wiltshire

Knowledge sharing

SIR – You ask whether the open-source method can do anything new, or whether it's limited to doing already-known things more cheaply (“Open, but not as usual”, March 18th). Relax. For hundreds of years now, academics have been sharing ideas openly and building on each others' work. Newton's laws were open-source, as were Maxwell's equations and quantum mechanics. Most of the formative early research in computer science was published rather than patented, as was the human genome (just). Openness is the original way of doing things, not a transient innovation.

Ross Anderson
Professor of security
engineering
Cambridge University
Cambridge, Cambridgeshire

SIR – You criticise open-source methods for not guaranteeing quality. But the alternatives don't either. To the extent that we choose to ignore the ostensible structures of organisations to get things done, we are already choosing other ways of doing things well. Why is this so hard to admit?

Ant Evans
London

Talk peace

SIR – You conclude “there is not much the Palestinians can do” about being shut out of Israel's unilateral withdrawal plan (“Shutting itself in, hoping for the best”, March 25th). In fact, there is a lot that the Palestinians could do. For starters, their government could renounce violence, recognise Israel, and declare it is willing to negotiate a permanent peace. Those who supported Hamas because of the promise of social services could demand that Hamas change its stated goal of destroying Israel. Those who were opposed to the extremism of Hamas could voice discontent at the deterioration in living conditions caused by Hamas's policies. Your statement implies that the Palestinians are only passive onlookers. It absolves extremists and their supporters from responsibility for creating and maintaining this impasse.

Mark Shapiro
Skokie, Illinois

Spuds you don't like

SIR – The argument that the dieting craze has led to diminishing returns for American potato farmers should send a clear signal to the industry that it is time to take its product in a new direction (“Pass the spuds”, March 25th). Dairy farmers didn't grumble about consumers on diets and were quick to market new, healthier products, such as fat-free chocolate milk, aimed towards children. If they want to increase sales, farmers should reinvent the potato to take account of healthier, carb-conscious Americans.

Kris Winder
Malibu, California

The unwelcome guest

SIR – The decision to grant asylum to Charles Taylor in 2003 by Nigeria's president, Olusegun Obasanjo, was a huge undertaking that helped restore peace to Liberia ("Bringing the wicked to the dock", March 11th). You made it sound as if Mr Obasanjo was merely harbouring a tyrant. Don't forget that the conflict in Liberia and Sierra Leone also affected Nigeria, both in terms of money and human life, as Nigeria became the destination point for most of the refugees at the height of the crisis. In any case, Mr Taylor would not have even been in Nigeria if the United States, which has strong historical links with Liberia, had acted sooner in bringing the region's troubles to an end: the Liberian war started well before the first Gulf war.

Mejidi Anaisi Suleiman
Abuja, Nigeria

Word for word

SIR – David Holcberg of the Ayn Rand Institute thinks people should have the right to grow and sell their vital organs (Letters, March 25th). Well, following the same line of argument in his letter, I think people should have the right to grow and sell their daughters. After all, the law recognises our authority over our children, so it should recognise our right to sell our daughters. Those who could afford to buy a girl would benefit at no one's expense but their own. Those unable to pay would still be able to rely on charity. If the government upheld these rights, many of the thousands of men now waiting for a date would be spared hideous suffering. How many? There is only one way to find out: set these people free.

Davide Mozza
Pisa, Italy

Stretching a metaphor

SIR – Your article on left-handed snails referred to a "sinister minority" and "dexterous crustaceans" ("On the one hand", March 25th). But you also said that peeling the wrong way with a right-handed potato peeler is merely "awkward". Why didn't you just say *gauche*? Please try to be more adroit—even if this requires knowing a bit of French.

Richard Colman
Orinda, California

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Italy's election

A sad Italian story

Apr 6th 2006 | MILAN AND ROME
From The Economist print edition

AFP

Disillusioned Italian voters may dump Silvio Berlusconi's centre-right coalition next week, but a government led by Romano Prodi might be little better

Get article background

ELECTIONS never used to matter much in Italy. For most of the post-1945 period, they were frequent, they led to a ragbag of short-term, centrist coalitions and they produced a string of faceless prime ministers who seemed to change almost yearly. Yet despite—or perhaps because of—this, the economy prospered and living standards of ordinary Italians rose fast.

None of these things is true of the election being held on April 9th and 10th. It comes after a centre-right prime minister has, for the first time in post-war Italy, served out an entire five-year term. That prime minister is Silvio Berlusconi, a controversial media tycoon who is also Italy's richest man.

But the biggest difference from the past is that the economy over which Mr Berlusconi has presided has done so badly. Last year GDP growth was near-zero; this year's forecast has just been cut from 1.5% to 1.3%. Italy deserves its title as the new sick man of Europe. It is in far worse shape than Germany or France. And the pressing need to find a cure for that sickness means that the outcome of next week's election matters.

It is also one reason why the battle between Mr Berlusconi's centre-right House of Liberties coalition and the centre-left Union group led by Romano Prodi, a former prime minister, has been so vitriolic. Another is that Mr Berlusconi is a colourful, often outrageous character whose appeal

lies as much in his entertainment value as in his politics. In recent weeks he has likened himself to Napoleon and Jesus Christ; insulted Italian businessmen, the media and China's Communists; and heaped abuse on Mr Prodi and his supporters (“vampires” and “dickheads” being two recent samples). He has also managed to squabble with all his coalition partners.

Indeed, as the election has drawn near, some centre-right leaders have taken on an air of desperation, and begun manoeuvring for the aftermath of a defeat. The centre-left's opinion-poll lead was briefly dented at the start of the year, but it has since been a remarkably consistent 3-5% (publication of poll data is banned in the final two weeks of election campaigns). Mr Berlusconi, a consummate media performer, had high hopes for his two televised debates with Mr Prodi, a bespectacled former professor and European Commission president whose communication skills are notoriously bad. In the event Mr Berlusconi comprehensively lost the first debate, on March 18th.

Yet, in a rancorous final debate on April 3rd, he seized back the initiative with a string of promises to tempt the undecided. In particular, in the dying seconds, when Mr Prodi no longer had a right of reply, he landed what he hoped would be the killer punch. Giving viewers his best salesman's grin, Mr Berlusconi said he planned to slash the tax on bank current accounts and, even more enticingly, to abolish the municipal tax on primary residences—which was not in his manifesto.

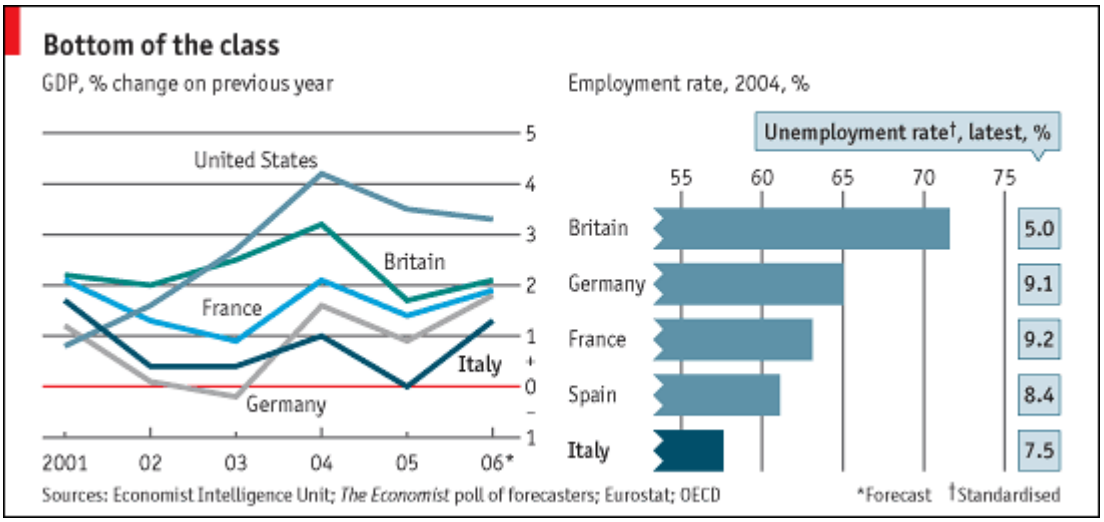
The left dismissed this as just another populist gimmick and demanded to know how he would pay for it. But it is doable. The tax brings in some €2.3 billion ($2.8 billion) a year, a large amount but not so huge as to ravage the public accounts. Moreover, a future Berlusconi government might not make up the shortfall. Most local authorities lean to the left. If they have to cut services, would that worry a conservative administration in Rome?

Despite Mr Berlusconi's last-minute offerings, the odds are still, just, on a centre-left victory next week. But the margin is likely to be small. That is partly because, in a final effort to keep out the opposition, the government has changed the voting system. Since 1993 three-quarters of the seats in parliament have been elected on a first-past-the-post basis. Italian politics has evolved away from the old set-up, with lots of parties feuding among themselves before forming a kaleidoscope of differing coalitions, towards a new bipolar system with two broad coalitions of parties on the centre-right and centre-left.

All the evidence is that voters welcomed this change, as it gave them a clearer choice at elections. Yet last year the government junked it to move back to full proportional representation (albeit with a threshold for parliamentary seats and a complex top-up formula for the winning side). The new voting system seems likely to produce a smaller majority for the centre-left if it wins, especially in the Senate. Indeed, it is possible that the two chambers could end up in different hands, a recipe for policy paralysis.

A close result would make it much harder for Mr Prodi to control his broad coalition, which embraces, on the right, the Margherita Party led by Francesco Rutelli (who lost for the centre-left against Mr Berlusconi in 2001), the reformed ex-communist Democrats of the Left, led by Piero Fassino, and, on the far left, the unreformed Communists, led by Fausto Bertinotti. Should Mr Berlusconi's centre-right coalition bounce back and win, it too is likely to have a wafer-thin majority. The prospect is that any new government, from either side, will be weak and beholden to fractious parties at the extremes.

Would that make any difference? Yes, for the challenges facing a new government are immense. And, as France's protesters and strikers across much of Europe have been showing, none is harder or more pressing than the need to set about reforming and restructuring the economy.



Over the past five years, Italian GDP growth has averaged less than 0.7% a year, by far the slowest rate among big OECD countries. The rate of employment of the working-age population, at 58%, is the lowest in western Europe (see charts). Productivity growth has been at best static, and at times negative. Competitiveness has declined shockingly: since the start of Europe's single currency, the euro, in 1999, unit labour costs relative to the average have climbed by 10% in Italy, but fallen by a similar amount in Germany. And Italy's public finances, which improved in the late 1990s, have deteriorated. The public debt is at 106% of GDP and rising, and the budget deficit is some 4% of GDP (against the euro area's stability-pact ceiling of 3%).

The macroeconomic picture is thus pretty ugly. Yet Italy's situation is worse even than this implies. If it were merely a case of putting right the public finances and waiting for Europe's economic upturn, that would be simple. But the ills of the Italian economy are deeper and more structural—and will take years to cure.

For a start, Italy is in the wrong industries, from textiles and shoes to white goods and machine tools. These manufacturing businesses are now vulnerable to global competition from countries with lower labour costs—and China has duly taken some big bites out of Italian industry over the past decade. The country has too many small firms, and not enough big ones. It is weak in high-tech. The *mezzogiorno*, or south, is a corrupt, underemployed mess that holds back all of Italy—and it accounts for 35% of the population.

Above all, Italy's service sector is woefully underdeveloped. Roger Abravanel, a consultant at McKinsey in Milan, points out that, if Italy wants to match Britain's rate of employment, it needs as many as 5m new jobs. With agriculture in decline, manufacturing under attack from China and the public sector bloated, most of those jobs must be created in private-sector services. Yet Mr Abravanel notes that Italy has more barriers to competition or to new entrants in services than almost any other rich economy. The *mezzogiorno* badly needs more services, in tourism and in caring for the old: properly developed, it could aspire to be the Florida of Europe.

In the past Italy had a safety valve that enabled it to live with these economic weaknesses: devaluation of the lira. That course was not costless—and, in any case, was no longer available once the country had joined the euro. For all the market chatter about Italy being pushed out of the single currency, that is not a serious option: it would lead to painful default and recession, Argentina-style.

In effect, the euro and global competition are forcing Italy into a wholesale transformation, away from small-scale manufacturing, family firms and a reliance on low labour costs and devaluation,

and towards larger enterprises, more service industries and higher value-added activities. The challenge for the government is to ensure that this transformation happens quickly and in the least painful way. This requires more than sound macroeconomic policy: it demands a programme of liberalisation, privatisation and the injection of more competition across the board.

Silvio's legacy

It would be a travesty to lay the blame for Italy's economic failings at the door of the Berlusconi government. In reality, their origins date back three decades or more. Yet it is fair to ask what the centre-right government has done to tackle them. And the short answer is: precious little.

In only two areas has it pursued serious reforms: pensions, where it is raising the retirement age and bringing in private pension funds, and the labour market, where it passed the “Biagi” law to make it easier to hire workers on short-term contracts. Thanks to these reforms, Italy's prospective pension bill and its overall unemployment (though not its youth unemployment) compare well with other European countries. But in general the story has been of a failure to promote competition, to privatise state-owned businesses or to liberalise what is one of the most highly regulated economies in the OECD.

This explains why Italian business is so disappointed by the Berlusconi government. In 2001, many bosses swallowed their doubts about the conflicts of interest inherent in Mr Berlusconi's ownership of Mediaset, which controls the three main private television channels, and about the mass of legal cases outstanding against him, because they hoped that a centre-right government with a substantial majority—by some claims, the first such government since the war—would pursue a programme of Thatcherite reforms.

Those hopes have been dashed. The government has been beset in part by in-fighting. None of the three biggest centre-right parties after Mr Berlusconi's Forza Italia—the National Alliance, led by Gianfranco Fini, the Union of Centre and Christian Democrats, now led by Pier Ferdinando Casini, and the Northern League, led by Umberto Bossi—is a true believer in free-market liberalism. All are beholden to special interests. Even Mr Berlusconi is no advocate of competition: his fortune was based on protected monopolies and the obtaining of political favours.

A further problem is that the government's attention has been so focused on passing laws to help Mr Berlusconi avoid conviction in various legal cases brought against him. Criminal offences have been downgraded; statutes of limitation (ie, periods after which a crime is extinguished) have been shortened; an unsuccessful attempt was even made to give the prime minister blanket immunity from prosecution. These measures, plus the government's predilection for amnesties for tax evasion, money laundering and illegal building, have not only distracted the government; they have further lowered the quality of Italian public life.

Politicians on the centre-right promise to do better in a second term. Yet the record of the past five years is terrible. And the campaign pledges of Mr Berlusconi—including higher pensions, tax credits for having children and a raft of tax cuts besides his latest promise to scrap municipal taxes—are hardly reassuring.

The real concern is whether a centre-left government might do any better. One ray of hope is that the previous centre-left government did more than Mr Berlusconi in such areas as privatisation, as well as getting the public finances into better shape. Unlike Mr Berlusconi, Mr Prodi and his advisers talk the right language about the need for more competition. And the producer lobbies that are fiercely against reform—shopkeepers, small tradesmen—are often stronger within centre-right parties than within the centre-left.

Yet the big difficulty for Mr Prodi is that he is hamstrung by coalition partners who are unenthusiastic about freer markets, notably Mr Bertinotti's unreconstructed Communists. Ominously, Mr Bertinotti declares himself entirely happy with the 280-page manifesto of the centre-left, which is a careful compromise between his views and those of others within the coalition. He also claims that Mr Prodi has shifted leftwards since he was prime minister in 1996-98. On that occasion, the government was brought down by none other than Mr Bertinotti, but so long as the centre-left sticks to its programme, he promises not to do it again.

A centrepiece of that programme is to reduce the social-security tax on labour by five percentage points, a bigger cut than is promised by the centre-right. It will be financed by raising taxes on income from capital and by reintroducing inheritance taxes. On labour markets, however, the Prodi platform proposes partly to reverse the Biagi law by making it less attractive to employ people on temporary contracts. And Mr Bertinotti declares himself firmly against privatisation—though, intriguingly, he is not against all liberalisation.

It is hard to avoid the conclusion that a Prodi-led government with a small majority is unlikely to be either willing or able to promote reforms on the scale that Italy badly needs. So what might happen? Some hopeful politicians in Rome talk of the collapse of a new government leading to a reassembling of a middle-of-the-road coalition that took in more centrist elements from both sides—a sort of rebirth of 1980s-style Christian Democracy. Others talk of a broader German-style “grand coalition” of left and right together.

A failure by yet another Italian government to improve the economy could indeed lead to a reshaping of the political map. But the truth is that, even in the centre, few politicians or parties have much appetite for pushing reform and taking on producer lobbies. The real sadness of Italy, maybe reflecting its long political divide into Catholics and Communists, is that it has so few liberals. Even today, as Emma Bonino, leader of the tiny Radical Party, puts it: “In Italy, to be liberal is somewhere between a sin and a crime.”

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Italy's ageing leaders

Heaven for gerontocrats

Apr 6th 2006 | ROME
From The Economist print edition

Why ageing leaders may be a product of a gloomy economy

IT IS odd that in this election the same two men should be vying for prime minister as in 1996 (when Romano Prodi won). Odder still is that both are of pensionable age. If the next legislature lasts its five-year term, Silvio Berlusconi will finish it at 74 and Mr Prodi at 71. Italy's head of state, Carlo Azeglio Ciampi, is 85—and there's serious talk of his re-election. Were he chosen again in May, he would be 92 by the end of his mandate.

Italy has become a nation of gerontocrats. In no other country in Europe do the old cling on so fiercely. The exclusion of the young has become a campaign issue. President Ciampi is not the only member of the post-war generation still in a position of influence. A former prime minister, Giulio Andreotti, remains politically active at 87, thanks to his seat in the Senate. He is one of seven life senators, of whom the youngest, ex-President Francesco Cossiga, is a mere 77.

You cannot even run for the Italian Senate until you are 40—the highest minimum age for any legislative chamber in Europe. A survey by the Forum Nazionale dei Giovani, a pressure group, finds that only 5% of Italy's lawmakers are under 40; the one country in western Europe with a smaller share is France. (Italy also has the tiniest share of female lawmakers, lower even than France's.)

Old men dominate many walks of Italian life, even where youth might be thought to be of the essence. The top quiz-show host, Mike Bongiorno, was a partisan in the second world war. A popular rock star, Adriano Celentano, made his debut in 1957. And grey power is advancing. A study for the centre-left think-tank, Glocus, found that, between 1998 and 2004, the share of over-60s in Italy's “Who's Who” rose from 46% to 53%.

The study argued that Italy was gerontocratic because it was not meritocratic. But slow growth may play a part. A former European Commissioner who is planning to run for the presidency, Emma Bonino (at 58, a mere babe), notes that a stagnant economy increases intolerance towards new entrants.

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Republican woes

The long goodbye

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From The Economist print edition

The downfall of their most powerful congressman gives Republicans a chance to get rid of what he represented

AP

THE late Enoch Powell, a right-wing British politician, once observed that all political careers end in failure. This week Tom DeLay, a Texan who makes Powell look like a pinko, proved this aphorism in spectacular fashion. Mr DeLay had resigned in September from his position as House majority leader when a Texas grand jury indicted him on charges of trying to evade the state's election laws, but signalled his continued appetite for power by fixing himself a seat on the Appropriations Committee. On April 4th he announced that he will not run for re-election in November and will resign from Congress in the next few months. Republicans are thus deprived of the most important architect of their recent hegemony.

Few politicians have risen so far and fallen so fast as Mr DeLay. He came from the opposite end of the social scale from George Bush: born in hardscrabble Laredo, Texas, he dropped out of Baylor University and made his career as a pest-control specialist before discovering politics. But he became the most powerful Republican in the House in 1995-2005, first as House majority whip and then as leader. Indeed, his unrivalled skills as a party manager and vote-counter made him perhaps the most powerful Republican congressman of the post-war era. He hammered the Republicans into a coherent governing majority—hence his nickname, “the Hammer”—and repeatedly squeezed legislation through by the narrowest margins.

Mr DeLay's humiliation has been very public. In September he was forced to surrender his palatial suite in the Capitol (which was always well stocked with food to keep his fellow legislators happy) for an office in a building populated by freshmen. Last week a man who once strode the floor of the House slapping backs and exchanging jokes was seen coming in and out quietly by a side door. This week Washington could talk about little else but the “real” reason for Mr DeLay's sudden departure—and few of the speculations were flattering.

Mr DeLay's own explanation is that he had seen private polls suggesting that he had only a 50-50 chance of holding on to his congressional seat in suburban Houston. Mr DeLay's personal ethics, rather than the Republican agenda, had become the issue—and so he manfully decided to step aside. Perhaps. Although his base of straight-ticket Republican voters would probably have stayed loyal, many were wavering. A *Houston Chronicle* poll showed him trailing his Democratic opponent, Nick Lampson (a former congressman ousted by a DeLay-orchestrated redistricting) by 30% to 22%. One of Mr DeLay's biggest worries was that a former Republican congressman called Steve Stockman—a conservative member of the class of 1994—had decided to run against him as an independent.

Still, Mr DeLay's decision to resign comes only a week after Jack Abramoff, a super-lobbyist, was sentenced to almost six years in prison, having pleaded guilty to conspiracy and wire-fraud charges, and only a few days after his former deputy chief of staff, Tony Rudy, pleaded guilty to corruption and bribery charges in connection with the Abramoff probe. Mr DeLay continues to deny any personal wrongdoing in the affair. But he was undoubtedly close to Mr Abramoff—and undoubtedly took golfing trips with him. It doesn't help that Mr Abramoff's closest business partner, Michael Scanlon, was also Mr DeLay's former press secretary.

Reactions to Mr DeLay's departure were predictable. Republicans from George Bush down praised him for his work in building the Republican majority and pushing through their agenda. Democrats couldn't conceal their glee. This was a man who had been the driving force behind Bill Clinton's impeachment; who had completely marginalised Democrats from decision-making in Congress; who had not only redistricted six Democrats out of their seats in Texas but had also spurred on the Texas Rangers to pursue Texas lawmakers who refused to sign off on his scheme; who had made no secret of the fact that he regarded secular liberals not just as political opponents but as ideological enemies. Only George Bush's impeachment or Karl Rove's imprisonment could have brought more joy to blue America.

Mr DeLay could not be a better villain if he had horns sprouting from his head. His ethical problems are a perennial excuse for the Democrats to repeat their jeremiad about the “culture of corruption”. On top of his indictment and the Abramoff connection, he was reprimanded three times by the House Ethics Committee for misusing his post when he was majority leader.

Mr DeLay also embodied all the things that worry swing voters about the Republican Party—from ideological zeal to religious fervour to southern-fried values. Mr DeLay had a habit of delivering fire-and-brimstone speeches against liberalism in general and government in particular (he first got involved in politics because of his hatred of the Environmental Protection Agency, which he described as “the Gestapo of government”). Only last week he was a keynote speaker at a conference on “the war on Christians”, where he warned his audience that “the enemies of virtue” were on the march. Liberals cannot conceal their delight that the next person who could face legal jeopardy in the Abramoff case is Edwin Buckham, Mr DeLay's former chief of staff, who is both a lobbyist and an ordained minister, and who served as the Hammer's spiritual adviser.

Many Republicans are privately breathing a sigh of relief at Mr DeLay's departure. For one thing, his decision makes it more likely that they will hold on to his congressional district, which could make all the difference in a tight election year. (Mr DeLay's announcement has already drawn two Republican candidates into the race, David Wallace, the mayor of Sugar Land, and Tom Campbell,

a lawyer who came second in the March 7th primary.) But if the Republicans are going to have any chance of retaining their current position as a majority party, they need to do more than build on Mr DeLay's legacy. They need to tackle some of the structural weaknesses that the Hammer built into the Republican machine: the fact that the party is too southern, too religious and too tied to K Street. In other words, they need to say goodbye not just to Tom DeLay but also to DeLayism.

This might sound a little naive. What is wrong with being “southern” when the South is the fastest-growing region in the country? What is wrong with being religious in a country where the vast majority of people believe in God? And what is wrong with cultivating ties to business lobbyists in a country that regards business as a blessing not a vice? K Street was overwhelmingly Democratic from the New Deal to 1994, when the Democrats were the majority party. Why shouldn't it go Republican now that the Republicans are the majority?

Part of the problem is one of balance. The party's current southern bias risks alienating other regions—the party's poor showing in California and the north-east has a lot to do with regional rivalries as well as ideology—and eventually turning the party into a mere regional party rather than a national one. The party's current religious flavour risks alienating other parts of the Republican coalition—particularly moderate business voters and anti-government libertarians. Twice as many people now tell pollsters that the Christian right has too much influence in Washington as tell them that it has too little.

The other problem is the politics of quid pro quo. The period of Republican dominance has coincided with a huge explosion in lobbying: since 1994 the number of registered lobbyists has risen almost fourfold, to 36,000. This has created a lucrative career path for Republican staffers. But it has also weakened the Republican Party's appetite for cutting government rather than using government power to reward its allies (in fiscal 2006 lawmakers added $29 billion-worth of earmarks to spending bills, largely at the behest of lobbyists). And it has contributed mightily to the growing appetite in the country for throwing the bums out.

And what of Mr DeLay himself? No doubt America hasn't heard the last of such a colourful and polarising figure. There is the little matter of his legal problems: at the very least he still has to face indictment charges in Texas. But in the long term Mr DeLay, who celebrates his 59th birthday this Saturday, promises to continue devoting his energies to the grass-roots conservative movement.

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Golf and politics

Hacks who hack

Apr 6th 2006 | WASHINGTON, DC
From The Economist print edition

The best test of a politician's character is how he handles his clubs

Reuters

In the lake again

AS HE falls into the mud, Tom DeLay may be dragging with him the good name of golf. Americans, by and large, don't mind if politicians dabble in the Royal and Ancient game. (Unlike the intolerant South Koreans, who hounded their prime minister out of office last month for playing golf when many felt he should have been working.) But recent revelations of lobbyist-funded junkets to posh golf courses threaten to put the game out-of-bounds to American politicians who treasure their image.

That is the startling prediction of Don Van Natta, author of "First Off the Tee—Presidential Hackers, Duffers and Cheaters from Taft to Bush" (PublicAffairs), the best book ever written on American politics. In the 1960s, notes Mr Van Natta, golf was seen as the preserve of rich white Republicans. John Kennedy, a gifted swinger, hid his habit to avoid comparison with his golf-mad Republican predecessor, Dwight Eisenhower.

But with the spread of public courses accessible to regular Americans, golf has lost much of its elitist stigma, and presidents have indulged in it without shame. Bill Clinton was notorious for cheating, not in a ball-down-the-trouser-leg way, but in a brazen "That-shot-didn't-count-so-I'll-take-a-mulligan" way. Tom DeLay gave him a hard time for it. (So did the press. Corey Pavin won the US Open shortly after playing with Mr Clinton. Mr Clinton's spokesman quipped that "The president's pointers must have been pretty good." A journalist asked: "So Corey took mulligans when nobody was looking?")

The current golfer-in-chief is a risk-taker. George Bush "doesn't envision the terrible consequences that can come from trying to hit a ball 250 yards over a lake," says Mr Van Natta. Quite.

Congressmen also waste good walks like other people's money. *Golf Digest* magazine lists 85 who play. Most of the best are Republicans. Why? Working people play basketball, middle-income people play baseball and wealthy people play golf, guesses Mark Udall, the top golfer among congressional Democrats, with a handicap of 1.8. "Republicans are the party of the wealthy, [and] the wealthier you get, the smaller your balls become," he adds. But he expects the game to become more bipartisan and, perhaps, to make better politicians. "Golf teaches patience and humility," says Mr Udall. "There is not nearly enough of that in Washington today."

Paying for Iraq

Blood and treasure

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The Iraq war is costing America hundreds of billions of dollars. But would containment have been much cheaper?

WHILE George Bush and his opponents argue about Iraq, the war of words is turning into a firestorm of figures. Iraq has already cost America more than $250 billion, and economists are now debating the future price tag. Estimates of the eventual cost range from just over $400 billion to more than $2 trillion. This battle of numbers is as much about politics as money.

Even if the war were not quite as expensive as some make out, many Americans would still be totally opposed to Mr Bush's handling of Iraq. His critics say that he rushed into war, lied about his reasons, failed to plan adequately and botched the execution. Naturally enough, they view the high and rising cost of the war as evidence of those transgressions.

The predictions of Mr Bush's team were clearly wrong. His top economic adviser at the time, Larry Lindsey, said the war would cost $100 billion-200 billion, and Democrats on the House Budget Committee agreed. Donald Rumsfeld, the defence secretary, backed an alternative guess of $50 billion-60 billion. Both sets of figures have proved too low.

How high will the price tag go? Harvard University's Linda Bilmes and Columbia University's Joseph Stiglitz (a Nobel laureate and chief economic adviser in Bill Clinton's administration), reckon that the war could cost America an eye-catching $2.24 trillion through 2015*. Scott Wallsten and Katrina Kosec, in a study for the AEI-Brookings Joint Centre, predict that the war will eventually cost America $540 billion-670 billion†. (On the AEI-Brookings website, they have also posted an interactive calculator that lets visitors make their own forecasts††.) A third study, by three economists at the University of Chicago's business school—Steven Davis, Kevin Murphy and Robert Topel—and based on what was known before the war, gives seven scenarios for it, of which the likeliest two (with some hindsight) suggest a final cost between $410 billion and $630 billion**.

Why is the Bilmes/Stiglitz estimate so high? Partly because they attribute a number of economic ills—oil prices, interest costs and foregone government projects—to the war in Iraq. These seem questionable claims. Oil prices are indeed much higher now than in early 2003, but the war's impact on global oil supplies has been relatively small; a surging world economy has driven up demand. Including the interest payments on America's Iraq spending is also strange. Alan Krueger, a Princeton University economist writing in the *New York Times*, has likened this to counting interest payments on a home mortgage as part of the purchase price. As for government projects, that estimate hinges largely on the perennial debate over whether more public investment would yield net benefits for the economy.

Stripping out these “macroeconomic effects” still leaves a forecast of between $840 billion and $1.19 trillion through 2015, much more expensive than the others. Two of the studies come up

with similar tallies for soldiers' pay, weapons, ammunition and supplies; but the estimates for these from Ms Bilmes and Mr Stiglitz are about $100 billion or so higher.

Casualties—the human half of the "blood and treasure" equation—are also a big part of the cost to America, and all three studies treat them as such. Efforts to attach dollar figures to human life offend some people, but governments and courts do it often for insurance cases, disability payments, safety regulation and so forth.

Pick a number

Source	When	Total expected cost to US of Iraq war and reconstruction*
Donald Rumsfeld, defence secretary	Pre-invasion	$50 bn-60 bn
Paul Wolfowitz, former deputy defence secretary	Pre-invasion	Pay with Iraq's oil
Larry Lindsey	Pre-invasion	$100 bn-200 bn
Davis, Murphy and Topel	With hindsight, sort of	$410 bn-630 bn
Wallsten and Kosec	With hindsight	$540 bn-670 bn
Bilmes and Stiglitz†	With hindsight	$840 bn-1,190 bn

Source: Press reports and academic papers

*All figures rounded to nearest $10 billion
†Excludes claims of indirect macroeconomic costs

The Chicago economists treat these in a similar way to Mr Wallsten and Ms Kosec, attaching a cost to every soldier killed in Iraq of $6m-7m. Both studies assume an average cost of $1.3m for every wounded soldier. Ms Bilmes and Mr Stiglitz, again going further, add on to this another $3 billion annually that they expect the government to spend on veterans' care over the next 20-40 years, and also add another $70 billion-110 billion to the AEI-Brookings study's injury costs. Some economists say this is double counting; Ms Bilmes says it is not. Her paper is not clear enough to judge.

Both the Bilmes/Stiglitz and Wallsten/Kosec estimates —but not those of the University of Chicago—also assume that reservists earn less while serving in Iraq than in their civilian jobs, and count the income shortfall for those families as an economic cost. But a recent study by the Rand Corporation†††, based on payroll records for all reservists, found that those being deployed to Iraq make more money than they were earning as civilians. The popular belief that their pay drops appears to stem from flawed surveys that drew few responses—mostly, no doubt, from the minority of reservists who are losing income.

The cost of fingers crossed

A war costing $410 billion-630 billion sounds pretty grim. But the three University of Chicago economists also evaluate a wide span of possible outcomes if America had chosen the alternative to war. Their analysis includes four pre-war scenarios for containment and a range of probabilities for various contingencies. These suggest that reining in Iraq and hoping for the best could reasonably have been expected to cost $250 billion-700 billion.

They point out that even before the September 2001 terrorist attacks, America had 28,000 troops in the region around Iraq, as well as some 30 ships and 200 aircraft enforcing no-fly zones. The trio estimate that these forces alone were costing America $11 billion-18 billion a year.

In one sense this figure is too high, since it attributes all of America's military presence in the region to containment. On the other hand, America would probably have had to spend more on

curbing Iraq after 2002, since the sanctions regime was weakening. Another cost of containment is impossible to quantify: the propaganda provided to al-Qaeda by America's military bases in Saudi Arabia, and by the deaths of thousands of innocent Iraqis as a result of sanctions. But it is doubtful whether that propaganda weighed as heavy as America's invasion of a sovereign (if rogue) state, and the 30,000 Iraqi civilians who have been killed since the war began.

AP

Where the real costs fall

The Chicago economists also make some rough guesses about how long Saddam Hussein or his sons would have stayed in power. They assume that, without an invasion, there was a 3% chance every year that their rule would collapse, based on studies that others have done on long-lived repressive regimes such as North Korea, Cuba and the Soviet Union. Mr Hussein's sons, they argue, were in a strong position to succeed him.

Given what America was spending on Iraq, the authors reckon, it would have cost at least $200 billion, in present value terms, to keep containing it until it no longer posed a threat. So containment would have been pretty expensive for the United States, they argue, “even under the favourable assumption that it would be completely effective in achieving its national-security goals”.

The trio then go further. Containment would have involved a few contingencies, such as the periodic need to give the policy teeth with a show of force. So they factor those in, using a range of odds for each. Under a moderate containment scenario, they suggest a 10% chance every year of having to send troops to the region again to keep Saddam in line; a 3% probability each year of being drawn into a limited war; and a 10% chance that, sometime in the next decade, America would have been drawn into a major war with Iraq anyway.

Under these assumptions, and forgetting about any chance of WMD being used on American soil, the authors reckon that the expected cost of containment would have been around $400 billion, only a little less than the $410 billion that they now expect the war to cost. Those figures aside, their broader point is that the relative merits of war and containment hinged on various probabilities that were impossible to know in advance. Their analysis, as they claim, goes some way to explaining “the wide divergence of opinion about the wisdom of the Iraq war”.

In a way, though, that unceasing argument is beside the point. Mr Bush's problem is what Iraq is costing now, and how far that has exceeded the almost carefree estimates made at the beginning. One example can suffice. At the start of the war, the Pentagon estimated that the cost of Iraq's reconstruction would be $3 billion. It is now estimated at $20 billion, and still the lights are

scarcely on in Baghdad.

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* “The Economic Costs of the Iraq War: An Appraisal Three Years after the Beginning of the Conflict”, http://www.nber.org/papers/w12054

† see http://aei-brookings.org/admin/authorpdfs/page.php?id=1188

†† see http://aei-brookings.org/iraqcosts

** “War in Iraq versus Containment”, http://nber.org/papers/w12092

††† “Early Results on Activations and the Earnings of Reservists”, Jacob Alex Klerman, David S. Loughran, Craig Martin; www.rand.org/pubs/technical_reports/2005/RAND_TR2 74.pdf

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Nuclear dealings with India

A hard sell

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The battle moves to Congress

DID India negotiate too well for its own good in winning a controversial nuclear deal from George Bush during his visit to Delhi earlier this year? Mr Bush agreed to lift restrictions on America's civilian nuclear trade with India, even though it has the bomb and rejects the Nuclear Non-Proliferation Treaty. India insisted at the time that nothing in the deal would constrain its bomb programme. But that is what bothers Congress, which is now being asked to amend America's anti-proliferation laws. On April 5th the secretary of state, Condoleezza Rice, attempted to convince committees in both the Senate and the House that the deal was worth it.

Mr Bush badly wanted to boost America's “strategic partnership” with the world's biggest democracy and one of Asia's rising stars. The nuclear deal was India's price. Mr Bush has to convince the informal 45-nation Nuclear Suppliers' Group to change its rules too. But he has run into criticism in both places.

Ms Rice strongly defended the deal as being good for American jobs, good for friendship with India and even good for efforts to shore up the global anti-nuclear rules. It is that last bit that is hardest to sell.

One idea in Congress is to make the deal conditional on India ending production of fissile materials for weapons. But the administration had already pressed India for that and been rebuffed. It also wanted India to put its experimental fast-breeder reactor programme (which will produce lots of potentially bomb-usable plutonium) on a list of civilian nuclear facilities that, under the deal, will be subject to international safeguards. But India's bomb-makers said no. Since India is running short of uranium for all its reactors, America's negotiators ought to have had leverage. But Mr Bush wanted a deal and they had to settle for what they could get.

Despite the drawbacks, Congress is unlikely to turn the deal down flat, since this would badly offend India. But there is little enthusiasm for endorsing it either. And any attempt to force the changes through would badly offend Congress instead. The deal has strong support from Tom Lantos, the ranking Democrat on the House International Relations Committee. But last week Sam Nunn, a respected former senator, suggested it could harm America's interests and spark an arms race in Asia.

It is not only Congress that is uneasy. When American officials put the case to the NSG last month for making an India-sized hole in its rules on nuclear trade, they won firm support only from Russia, Britain, France and Australia. Many others, including China and Japan, asked hard questions. The worry is that making an exception for India will lead to a nuclear free-for-all. Jumping its cue, Russia has already broken ranks to supply fuel to two Indian reactors, arguing disingenuously that this is for “safety” reasons and thus within existing rules. “Unhelpful”, was the American response.

Equally unhelpful to those making the case for special American treatment of India are its ties to Iran, which is itself under a cloud at the UN Security Council on suspicion of secretly trying to build a bomb. Military-to-military contacts between the two have been expanding, and negotiations continue over a pipeline project that America flatly opposes. Nor is India likely to line up with America as a strategic partner against China, as some in Mr Bush's team would wish.

With nothing to constrain its nuclear plans at home or its friendships abroad, India can be happy with the nuclear deal it has struck with America. That is, if Congress lets it through.

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Presidential powers

Showdown averted

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From The Economist print edition

The Supreme Court declines to review the detention of enemy combatants

FOR George Bush, it was victory of sorts. The Supreme Court decided this week not to review the Padilla case, which challenges Mr Bush's authority to hold an American citizen indefinitely without charge as an “unlawful enemy combatant”. It thereby neatly sidestepped a long-awaited showdown over the president's claimed wartime powers. But it also avoided confirming the president's claims.

José Padilla was arrested in Chicago in 2002 on his return from Afghanistan. He was accused of being part of an al-Qaeda plot to blow up American apartment buildings with a radioactive “dirty bomb”, and was incarcerated without charge on a naval brig in South Carolina for more than three years. But a few days after the Supreme Court agreed last November to hear his appeal, the government suddenly decided to bring criminal charges against him, with no mention of any terrorist plot, and to transfer his case to a civilian court.

In March last year, a federal district court in South Carolina had ruled that the president lacked the authority to hold any American terrorist suspect indefinitely without trial. The presiding judge, Henry Floyd, appointed to the bench by Mr Bush, said he found the claim that Mr Padilla's detention was consistent with American law and the president's war powers “deeply troubling”. If such a position was ever adopted by the courts, he said, “it would totally eviscerate the limits placed on the president's authority to protect the citizenry's individual liberties.”

But this ruling was overturned by the Fourth Circuit Court of Appeals. It agreed with the administration that a congressional resolution, passed right after the September 11th terrorist attacks, gave the president “all powers necessary...to protect American citizens from terrorist attacks”, including the right to detain identified terrorist suspects indefinitely.

In declining (by a 6-3 vote) to review Mr Padilla's case, the Supreme Court has left that ruling intact. The administration's decision to indict Mr Padilla in a civilian court and to transfer him to a civilian jail, in accordance with his own wishes, made any consideration of his rights “hypothetical”, it said. But the question of whether Mr Bush could in future detain an American as an enemy combatant remains open.

There was more good news for Mr Bush this week when a jury in the sentencing trial of Zacarias Moussaoui, the only person in America to be indicted for direct involvement in the September 11th attacks, decided that he was “eligible for execution”. Allegations of witness-tampering by a prosecution lawyer had made it seem that Mr Moussaoui, a 37-year-old Frenchman of Moroccan origin, might escape the death penalty. But the judge allowed the trial to continue with evidence from other, untainted, witnesses.

Having at first claimed he knew nothing about the attacks, Mr Moussaoui, a self-confessed al-

Qaeda terrorist, stunned his own defence team by claiming last week that he himself was due to have flown a plane into the White House on the same day, had he not been arrested on minor immigration charges a few weeks earlier. The jury must now decide whether he should actually be executed.

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Massachusetts

Health care for everyone

Apr 6th 2006 | WASHINGTON, DC
From The Economist print edition

Hillary Clinton couldn't do it. Can Mitt Romney?

AS WAS discovered by Hillary Clinton a decade ago, it is politically impossible to fix America's health-care system all at once. Congress is too angrily divided, and the federal government lacks the muscle to impose a grand vision on unwilling states. The riddle of how to provide health insurance for the 46m Americans who lack it will have to be solved by trial and error in the states. This week, Massachusetts offered an intriguing proposal.

AP

Nicely covered

The state legislature passed a bill that would make health insurance compulsory. Just as everyone who drives a car must insure it, so everyone with a body must insure that, too. The only exceptions are those who can prove they are so rich that they can pay for major surgery themselves. The bill had near-universal support. Governor Mitt Romney, on whose proposal it is based, says he will sign it.

To make the plan work, Massachusetts will offer a mix of penalties and subsidies. Individuals will be allowed to buy health insurance with pre-tax dollars, just as firms currently can. Those who don't will be penalised through the tax code, and then fined. At the same time, private insurers will receive subsidies to offer bare-bones insurance to those who cannot afford fancier packages.

Of the 6.2m people in Massachusetts, about 500,000 lack insurance. They fall into three overlapping groups. Some are poor enough to qualify for Medicaid, but have not enrolled. Some are not quite poor enough for Medicaid, but get no insurance from their employers and cannot afford to buy it themselves. Others could afford it, but just don't buy it, perhaps because they are young and healthy.

Massachusetts has already done a good job of reducing the size of the first group. A new computer system uses the Social Security numbers of those who show up at hospital to see if they qualify for Medicaid, and automatically enrolls them if they do. The other two groups will be shrunk by imposing a levy on firms with more than ten employees that do not offer health insurance, and by forcing everyone who still lacks insurance after that to get some.

With more healthy people in the pool, average premiums should fall, or at least rise less quickly. The burden on emergency rooms should be reduced, because insured people are more likely to go

to a doctor before a problem becomes critical. Overall, the plan will cost no more than the state currently spends on the uninsured—about $1 billion a year, says an optimistic Mr Romney.

A novel aspect of the plan is the creation of a health insurance “exchange”, to relieve small firms of the need to conduct complex negotiations with insurers. Employees will be able to choose any plan approved by the state-backed exchange, and their premiums will be deducted from their pay cheques.

If the scheme works, other states will copy it. But that will depend on how much it ends up costing. No one wants to use the word “rationing”, but this is what happens in every country with universal health coverage. That said, Mr Romney's plan has more chance of success than Hillarycare ever did—which could help Mr Romney in 2008, when he will be seeking the Republican presidential nomination and then, perhaps, facing Senator Clinton.

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Lexington

The Tancredo tendency

Apr 6th 2006
From The Economist print edition

Dispiriting news on immigration

THE Republican Party is currently engaged in a fierce internal debate between two of its body parts—its head and its gut. The party's head tells it that it has no choice but to create a guest-worker programme. How else can it satisfy the ravenous demand for labour from business? And how else can it tempt America's 11m illegal aliens out from the shadows? But the party's gut tells it something completely different—just enforce the law. Build a fence. Arrest scofflaws. Send the bums back.

There are no prizes for guessing which organ is winning. Last December the House Republicans passed a gut-pleasing immigration bill that included a 698-mile $2.2 billion fence and stiff penalties for employers who employ illegal immigrants, but pointedly excluded any provision for guest-workers. This week the Senate tried to re-inject a dose of reason into the debate. But a bipartisan proposal by Teddy Kennedy and John McCain to set up a temporary visa programme looked as if it was going to fail.

Nobody is closer to the Republican Party's gut than Tom Tancredo, who represents Colorado's 6th District (roughly, Denver's southern suburbs). Mr Tancredo holds solidly right-wing positions on everything under the sun—though he briefly stopped taking money from the NRA in the aftermath of the Columbine shootings, which took place a few blocks from his house. He started his political career in the Colorado statehouse as a member of a group called “The Crazies” because of their fervent opposition to taxes. He signed a pledge calling for the elimination of public schools, despite the fact that both he and his wife had once taught in them, suggested bombing Mecca in retaliation for terrorism, and regularly voted against George Bush's “big government” legislation. But where Mr Tancredo has really made his mark—where he puts his red-faced fervour on full

display—is on the subject of immigration.

Mr Tancredo has been furious about immigration since 1975, when he was a high-school social-studies teacher and the Colorado legislature passed the country's first bilingual education law. This liberal over-reach not only offended his heartfelt belief that immigration must be balanced by assimilation (Mr Tancredo is himself the grandson of Italian immigrants who came to America without being able to speak English). It provided him with a subject that has driven his political career. Mr Tancredo doesn't stop at building fences and opposing guest-workers. He opposes birth-right citizenship (whereby babies born in the United States automatically become American citizens). He wants to deploy American troops along the border with Mexico. And he regularly salutes the Minutemen who unofficially do the job now as “heroes...not vigilantes”.

Mr Tancredo's beliefs and behaviour at first consigned him to the margins of Washington life. His immigration caucus attracted only 16 members. He frequently found himself giving speeches on immigration to an empty chamber (though the ever-present C-Span camera made it worthwhile). Karl Rove, Mr Bush's chief adviser, was so angry about his anti-immigration stance that he told him that he would never “darken the doorstep of the White House” again; and Tom DeLay, the former majority leader and a moderate by Mr Tancredo's standards, told him that “you cannot think of making a career in this place.”

It is a measure of how far the immigration debate has moved from head to gut that Mr Tancredo is now in many ways mainstream (and his immigration caucus has 92 members). The House immigration bill didn't include everything that he hoped for: a fence along the Canadian border, for example. But Mr Tancredo undoubtedly succeeded in defeating House Republicans who wanted to include at least a mention of guest-workers. And his fierce support for “enforcement only” policies is now pushing the Senate bill (and any possible compromise bill) much further in his direction.

A reprise of the pitchfork

There is no doubt that Mr Tancredo's triumph is a disaster in terms of both policymaking and Republican politics. First, it threatens to perpetuate the current policy paralysis. Do Americans really want to criminalise or deport 11m people? (George Will, a conservative columnist, points out that they would fill “200,000 buses in a caravan stretching bumper-to-bumper from San Diego to Alaska.”) Do they really believe that a giant Berlin wall will stop people? (Securing the border has been the main focus of immigration policy for the past two decades, yet the number of illegal immigrants has still swollen from 3m to 11m.) And do they really want their immigration policy to be made by the likes of Mr Tancredo's fellow cave-dweller, Dana Rohrabacher, who argues that prisoners can do the jobs vacated by deported immigrants (“I say, let the prisoners pick the fruits”)?

Mr Tancredo's rise is a disaster for Republican politics because it threatens to expose Republican divisions while alienating Latinos, who are America's largest and fastest-growing minority. The lesson of race-charged politics in the past is that trust between Republicans and ethnic minorities is far easier to destroy than to build: witness the collapse in Latino support for California Republicans after the race-baiting in the 1990s, or the collapse of black support for Republicans after the Katrina fiasco.

But it is a disaster that could get bigger. Mr Tancredo reflects the fears of millions of Americans: that immigrants steal jobs, over-burden public services and increasingly refuse to assimilate. He has a dedicated army of supporters, from Minutemen to America First activists. And he is threatening to run for the presidency in 2008. “Pitchfork” Pat Buchanan demonstrated the strength of the nativist streak in the Republican Party back in 1992, when he won 37% of the vote in the

New Hampshire primary against “King George” Bush. Mr Tancredo is showing every sign of becoming the Pitchfork Pat of the current decade.

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Writer-intern

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From The Economist print edition

The Economist's office in Washington, DC, seeks a writer-intern to help with coverage in the four months up to this November's elections. Experience unimportant, pay negligible. Please send a CV and a sample article to Washingtonintern@economist.com

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Politics in Canada (1)

Harper's five easy pieces

Apr 6th 2006 | OTTAWA
From The Economist print edition

The new prime minister stays strictly on message, offering few changes to a politically divided nation

Get article background

IN JANUARY, Stephen Harper pulled off a surprise election victory, ending a dozen years of Liberal rule. His Conservative minority government has since got off to a quiet, but not ineffective, start. The “throne speech”, delivered to a new session of parliament on April 4th by the governor-general, was Mr Harper's big chance to set out a sweeping vision of Canada's future. He chose not to take it: the speech was perfunctory (just 20 minutes) and largely confined to the same five promises that he had campaigned on. So Canadians were left unsurprised but little wiser about their new prime minister.

The five promises comprise an anti-sleaze law to make government more open, a cut in the sales tax, and moves to reduce waiting times for health care, give parents cash for child care and impose tougher sentences for gun crime. There were a couple of other signals. In deference to its minority status, the government would listen to opposition concerns, such as over the environment. The speech stressed that the United States was “our best friend”. Under the Liberals, relations with Canada's main trading partner were strained after George Bush took office.

For all the modesty of his ambitions, the speech revealed a stark contrast with Mr Harper's Liberal predecessor, Paul Martin, who had so many priorities he appeared to have none. Mr Harper's strategy is “don't overload yourself because lots of things will come up that aren't part of your plans,” he has said. The underlying plan is to do enough to win a majority when Canadians are ready for another election.

His first eight weeks have seen a few small stumbles. He enticed David Emerson, a minister in Mr Martin's government who had been re-elected as a Liberal MP, to join his cabinet. This brazen move still provokes bitterness in Vancouver. Mr Harper riled the Ottawa press corps by curtailing their access to ministers.

On the other hand, he acquitted himself well in his first forays abroad. A sudden trip to Afghanistan to visit the 2,200 Canadian troops there dampened a heated debate about their deployment. At a meeting with Mr Bush and Mexico's Vicente Fox at Cancún in Mexico on March 30th-31st, Mr Harper was ridiculed by reporters for wearing a waistcoat of the kind used by press photographers. Canadians may have taken more notice of Mr Bush's reference to the prime minister's “steely resolve” in the country's trade battle with its neighbour over softwood lumber.

At home, Mr Harper has assiduously courted French-speaking Quebec, where the Conservatives must win more seats if they are ever to form a majority government. He has met its Liberal premier, Jean Charest, three times, and promised the province a voice at some international

gatherings. He makes a point of starting most of his speeches in French.

Although the Conservatives have only 125 of the 308 seats in the House of Commons, Mr Harper stands a good chance of getting his five measures approved, starting with the accountability bill expected next week. Most are uncontroversial, the Liberals are leaderless, and the separatists of the Bloc Québécois have their minds on matters in Quebec.

Other issues are trickier. In the campaign, Mr Harper seemed sympathetic to provincial demands for more federal money. But only two of the ten provinces had budget deficits last year. In office, the prime minister may be more reluctant to loosen the federal purse strings.

For now, banging out his five-note tune may work for Mr Harper. But many interest groups are pressing for a more detailed vision. Business organisations sense a kindred spirit. They will be watching the budget, due in a few weeks, to see if action will follow the speech's throwaway reference to competitiveness and productivity.

Others want more details because they suspect that the moderate and centrist positions Mr Harper adopted to win the election do not reflect his real leanings. For most of his political career he has campaigned for smaller government and family values, causes championed by the Conservative government in his adopted province of Alberta (see article).

“He's more ideological than he makes out,” says Jim Stanford, an economist at the Canadian Auto Workers Union. He compares Mr Harper with John Howard, Australia's conservative prime minister, whose agenda did not become clear until after he won a majority. Since Mr Howard has been in office for a decade, that comparison might not displease Mr Harper. In fact, the Australian is more moderate than he sounds. And for now, Mr Harper seems happy to keep Canadians guessing.

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Politics in Canada (2)

Prairie regicide

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Alberta's premier outstays his welcome

THE people in Alberta call him King Ralph. For 13 years they have been happy to give carte blanche to Ralph Klein, their rumpled, tough-talking premier, granting his Conservative government four whopping majorities as he led his province from hard times to oil-fired prosperity. But Mr Klein's political antennae have finally failed him.

In mid-March, he told his party executive of his plan to retire in early 2008, after an extended farewell. But many in the party had other ideas. On March 31st just 55% of the delegates at a Conservative convention backed him to stay as leader. So this week Mr Klein backtracked, but not much. He said that in September he will ask the party to convene a leadership contest—no matter that unofficially this is already well under way—and that he does not expect to depart until December.

The premier remains popular with ordinary Albertans. They have forgiven foibles, such as his past drinking, outrageous remarks and angry outbursts, most recently flinging a Liberal policy book at a young legislative page. They like the folksy, guy-next-door manner of a high school drop-out who was a television reporter before entering politics as mayor of Calgary. They also credit him with laying the foundations for their current prosperity. By slashing spending, he balanced the province's budget while cutting taxes.

Soaring oil and gas prices did the rest: not only has the province paid off its debt, but this year Mr Klein handed every adult resident a C$400 ($340) “prosperity cheque”. Alberta has Canada's fastest-growing economy and its lowest unemployment, at 3%.

But having achieved fiscal nirvana, Mr Klein seemed uncertain what to do with it. This year's budget oddly failed to provide money for new schools in the fast-growing cities of Calgary and Edmonton. Some Albertans, remembering how the last oil boom turned to bust in the 1980s, want the province to set more aside for the future.

Mr Klein's decision not to go now sets the stage for nine months of internal squabbling. The front-runner among six hopefuls to succeed him is Jim Dinning, the province's treasurer during the era of budget cuts. A seventh candidate, Preston Manning, is publicly mulling his options. He founded the Reform Party, which later merged into the federal Conservative Party, and was a federal MP for nine years. His father was Alberta's premier for a quarter of a century. Were Mr Manning to win the job, Stephen Harper, the new federal prime minister, would not be the only heavyweight conservative leader in Canada.

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Peru's election

Taking on big mining

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From The Economist print edition

A nationalist candidate plans a tax grab

AFP

Humala prepares to gallop backwards

THE fishing port of Ilo is dominated by the nearby smelter of Southern Copper Corporation (SCC). Gloria Angulo, a retired schoolteacher, complains that the company has polluted the air and the sea, and does what it likes while not paying taxes. That is more or less the view of mining companies held by Ollanta Humala, the nationalist front-runner in Peru's election, whose rally in Ilo Ms Angulo turned out to watch last month.

Polls suggest that Mr Humala, a former army officer, will win the election of April 9th. But he looks unlikely to get an outright majority, and will probably face a run-off ballot in May against either Lourdes Flores, a conservative, or Alan García, a populist former president.

Mr Humala's promise to make multinational companies "pay to exploit the riches God has given all Peruvians" has contributed to his popularity. With mineral prices at their highest level for decades, many Peruvians agree that the tax take is too low.

The companies disagree. Mexican-owned SCC is one example. It recently made big investments in clean-up measures. Last year it paid $450m in taxes and royalties on sales of $2.2 billion. But SCC has been in Peru, under different ownership, since the 1970s. Newer entrants pay less. Last year, Peru's exports of minerals totalled $9.6 billion. In all, mining companies paid just $879m in taxes and royalties, according to an industry source.

A military government in 1968-80 expropriated several foreign mining and oil companies (though it eventually paid compensation). In the early 1990s, to attract mining investment when prices were low, the authoritarian government of Alberto Fujimori had to offer generous tax treatment: companies could write all investment off against tax, and were guaranteed "tax stability" for up to 15 years.

Investment totalling $9 billion has flowed into Peruvian mining over the past decade. In all, 27 projects involving many of the biggest names in the industry were covered by stability contracts, which among other things exempt them from a new royalty of up to 3% on sales approved in

2004. Though some of the contracts run out at the end of this year, a score will remain. They cover big projects such as Antamina, a copper mine part-owned by BHP Billiton, and Yanacocha, a gold mine co-owned by Newmont of the United States, which paid only $181.5m in taxes on sales of $1.2 billion in 2004.

Mr Humala intends to levy the 3% royalty on these projects and also to “review” the stability contracts. He calls for the “nationalisation” of “strategic” sectors, though he is cagey about precisely what this means (not expropriation, he says) or whether it applies to mining. He also wants to “renegotiate” a contract under which $1.7 billion was invested in the Camisea natural gas field, and give a bigger role to Petroperu, a state oil company.

Defenders of the contracts say that changing them will scare off investment, of which another $9 billion is projected over the next five to ten years. The National Mining, Petroleum and Energy Society, an industry lobby, points to a recent survey of world mining by the Fraser Institute, a Vancouver-based think-tank. This ranks Peru joint first in terms of mining potential, but 44th out of 64 countries or provinces on its policies towards the industry.

Mr Humala's strategy of focusing the campaign on these issues was helped when the gas pipeline from Camisea suffered a widely publicised rupture last month, the fifth since pumping began in August 2004. Mr García also now talks about reviewing the stability contracts, and even Ms Flores says she would take a look at the Camisea contract.

Mr Humala is riding a wider trend. He points to Bolivia, where the new government wants to “nationalise” natural gas exports, and Ecuador, whose Congress last week passed a law to increase taxes on oil companies. In Venezuela, Hugo Chávez's government has done the same (see article).

Most Latin American governments are woefully short of tax revenues. The balance of power in commodities markets has passed, for now, from buyers to suppliers. But Peru has paid a high price for frightening off investors in the past. And its government has not been a wise spender of the meagre revenues it already has.

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Television in Mexico

Boob tube

Apr 6th 2006 | MEXICO CITY
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A licence for monopolies

OPPONENTS have dubbed it the “Televisa law”, after the broadcasting empire that controls 70% of Mexico's television market and a large chunk of radio and publishing. They charge that what began as an attempt to set a modern regulatory framework for television and radio has ended up as a gift to incumbents—setting a dangerous precedent in a country where monopolies are as common as margaritas.

After weeks of acrimonious debate, the Senate approved the broadcasting law on March 30th, with the votes of the governing National Action Party (PAN) and the main opposition, the Institutional Revolutionary Party (PRI). But prominent senators from both parties rebelled. They claimed that their party leaders backed the law in return for favourable treatment for their candidates in an election in July. “I've never seen anything as shameless in all my years in politics,” claims Manuel Bartlett, a veteran political fixer from the PRI.

There is no evidence of such a trade. Defenders of the law say that, whatever its flaws, it is better than the status quo in which broadcasting licences were at the discretion of the government. The power to license and regulate broadcasting will pass to the telecommunications regulator. In another change, campaign advertising will in future be paid for by the Federal Electoral Institute, rather than by political parties. (At the moment, parties receive public funding, but then negotiate preferential rates with broadcasters.)

It bodes ill that the telecoms regulator itself opposed the law, as did the federal competition commission. The law also gives incumbent analogue broadcasters—chiefly Televisa and its main rival, TV Azteca—digital spectrum free of charge. That is a gift worth over $1 billion, say critics.

If Vicente Fox, Mexico's president, promulgates the law, opponents will challenge its constitutionality, says Mr Bartlett. A vote of more than one-third of either house of Congress would require the Supreme Court to consider the law (it could be rejected if eight of the 11 justices agree). In the Senate, opponents of the bill mustered just three votes fewer than a third.

Even if it survives, the law may have little effect on the election. The measures on campaign advertising will not take effect until 2007. And there are signs that the power of broadcasters to shape public opinion is waning. A massive publicity blitz by Felipe Calderón, the PAN's presidential candidate, has so far done little to erode the long-standing lead in the polls of Andrés Manuel López Obrador of the leftish Party of the Democratic Revolution—which opposed the law.

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Oil in Venezuela

Leaving the door ajar

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From The Economist print edition

The multinationals squeezed

Get article background

A DECADE ago, Venezuela abandoned its previous policy of restricting oil output to force higher prices, and threw its state-owned oil industry open to investment by multinationals. Under Hugo Chávez, a socialist, it is moving back, step by step, to the original policy.

On April 1st, the government took over two small fields, one operated by Eni of Italy and the other by France's Total, after they had jibbed at new contracts. Hitherto, a score of private firms ran 32 “marginal” fields under operating agreements, selling output of 500,000 barrels per day (b/d) to Petróleos de Venezuela (PDVSA), the state-owned giant. From now on they will be minority partners in joint ventures with PDVSA.

“We have buried that perversion that was the oil opening,” crowed Mr Chávez. “Anyone who doesn't like that can go elsewhere.” Most of the multinationals are not leaving—at least not yet. Exxon Mobil rejected the switch, and sold an interest in a field to Spain's Repsol. Norway's Statoil and Repsol itself concluded that some fields were no longer profitable. But others are staying—as they are in the Orinoco heavy-oil belt, where contracts remain unchanged.

The government argues that the “opening” amounted to privatisation by stealth. It further claims that the operating agreements were illegal. Their recision will boost government coffers by $2 billion a year, Mr Chávez said.

The operating agreements were struck when oil prices were at rock bottom. With oil edging towards $70 a barrel this week, the government is in part merely exercising its strengthened bargaining power. But it is also committed, rhetorically at least, both to state control and to a return to the policy of restricting production to bolster prices.

The new contracts involve a calculated risk. At PDVSA political loyalty has replaced technical excellence as the guiding principle. It claims to produce 3.3m b/d of crude, yet every independent source puts the true figure at under 2.6m. The diversion of part of PDVSA's revenues into social programmes casts doubt on its ability to maintain production if the multinationals do depart.

But at today's prices, many foreign companies may decide that Venezuela is still worth being in, even on Mr Chávez's increasingly demanding terms. Few countries with abundant reserves are open to foreigners. Compared to, say, Russia or Nigeria, “Venezuela may start to look more attractive,” says Michelle Billig of Pira Energy Group, a consultancy in New York. If foreign investment has recently slumped, that has partly been because there have been few projects on which to bid, she argues. Despite Mr Chávez's claim, the oil opening is not quite closed yet.

Thailand

Goodbye...or au revoir?

Apr 6th 2006 | BANGKOK
From The Economist print edition

Despite his renewed mandate, the prime minister is forced out by street mobs and an opposition boycott

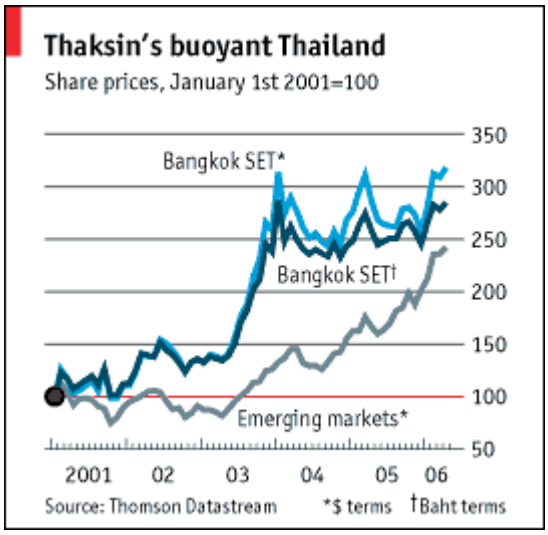
CHOKING on his words, at times close to tears: when Thaksin Shinawatra went on television on Tuesday April 4th to announce his resignation as Thailand's prime minister, there was nothing left of the tough-guy image that the former policeman turned business tycoon had cultivated. Although Mr Thaksin won around 16m of the 28m votes cast in a snap election held two days earlier, this was down from 19m in the 2005 election, partly because of a lower turnout and partly because so many voters selected the “no vote” box on their ballot papers, as they were urged to do by the main opposition parties, which boycotted the election.

Mr Thaksin said he was standing down to restore the “unity” of Thailand following months of street protests, organised by a group calling itself the People's Alliance for Democracy (PAD), demanding his resignation over alleged corruption and abuse of power. Although the protests have been peaceful and well policed, Thais have been living with the fear that they might turn bloody, as did the demonstrations in 1973 and 1992 that brought down military-led governments. Mr Thaksin explained that he did not want continuing strife to spoil the forthcoming celebrations for the 60th anniversary of King Bhumibol's accession to the throne, and urged all Thais to “love each other”. Earlier on Tuesday Mr Thaksin had visited the country's revered monarch at his summer palace on the Gulf of Thailand coast, to inform him of his decision.

Until the day of his resignation announcement, PAD and the opposition parties had spurned

various offers of reconciliation from Mr Thaksin, suspecting they were just ploys to help him cling to power. But on Tuesday they accepted his suggestion, made in a television interview the night before, to end the protests and the election boycott if he quit. In his resignation speech, he said he would remain as caretaker prime minister until parliament was convened, within 30 days. However, his ever-suspicious opponents objected to this, and by Wednesday he had announced that his chief deputy, Chidchai Vanasathidya—another former policeman—would immediately take over as acting prime minister.

Thailand's currency, the baht, has weathered the political storm rather well. But its stockmarket has stalled lately (though it has done well since Mr Thaksin first took over, in 2001, see chart) and forecasts for this year's economic growth have been cut from around 5% to perhaps 4%. Local and foreign investors are said to have put their plans on hold pending the resolution of the crisis. The government's planned spending on infrastructure "megaprojects", including better public transport, has also been frozen, as have its talks with America on a proposed free-trade agreement. In a ruling late last month, a senior court blocked Mr Thaksin's planned privatisation of the country's biggest electricity generator, declaring it unconstitutional. This was a further blow both to economic prospects and to Mr Thaksin, for whom privatisation has been a flagship policy—though it demonstrates how his opponents exaggerated when they claimed the "dictatorial" prime minister had captured and corrupted all the country's independent institutions.



By Wednesday, the Bangkok stockmarket had recovered to its best since January and the baht made gains, on hopes that the political crisis would be over quickly. But will it? Before parliament can convene, the electoral commission must re-run elections in 38 constituencies in which the sole candidate (from Mr Thaksin's Thai Rak Thai party) failed to get the one-fifth share of votes cast (including those "no votes") that is required under electoral law; and in at least one other seat where the sole candidate was disqualified. The commission ruled this week that new candidates can register for these re-runs, though so far the opposition parties say they will not take part. Although Mr Thaksin is still promising that a further general election will be held in around 15 months—after constitutional reforms proposed by a neutral panel of worthies have been passed, as the opposition has demanded—the opposition parties still express doubts about legitimising an interim parliament in which Thai Rak Thai will hold almost all seats, while Mr Thaksin remains the party's leader. More rallies are likely.

It is not clear yet if Mr Chidchai is anything more than a stopgap. As the minister responsible for security, he is partly culpable for the botched policing of the Muslim insurgency in Thailand's southern provinces, whose death toll continues to rise. So he may not be the best choice. Businesses and the financial markets would prefer someone like Somkid Jatusripitak, the commerce minister, who is a career technocrat with a business doctorate from an American university. In a television interview given the day before his resignation speech, Mr Thaksin named Mr Somkid, as well as Pokin Polakul, a former speaker of parliament's lower house, as possible successors.

Even if the election re-runs produce a quorate parliament, the street protests die down and the opposition parties rediscover their sense of duty and rejoin the democratic process, Thailand may still not be out of the woods. Michael Nelson, a political scientist at Bangkok's Chulalongkorn University, explains that Mr Thaksin is the "glue" that holds together Thai Rak Thai—a collection of disparate factions he assembled in the late 1990s—and without him at the wheel, the party may

fall apart. If, on the other hand, he remains visibly in the driving seat, the opposition and PAD may well decide that his successor as prime minister is a mere puppet, and start making trouble again.

The same could be true if in the future Mr Thaksin seeks a comeback, hoping voters will have forgotten all the corruption allegations but will remember his strong policies on health and poverty reduction, and his noble sacrifice in stepping down to avoid further strife. Do his opponents, and the Bangkok elite that are their main supporters, expect to exercise a permanent veto over his return? They shouldn't.

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Malaysia

Badawi's grand plan

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From The Economist print edition

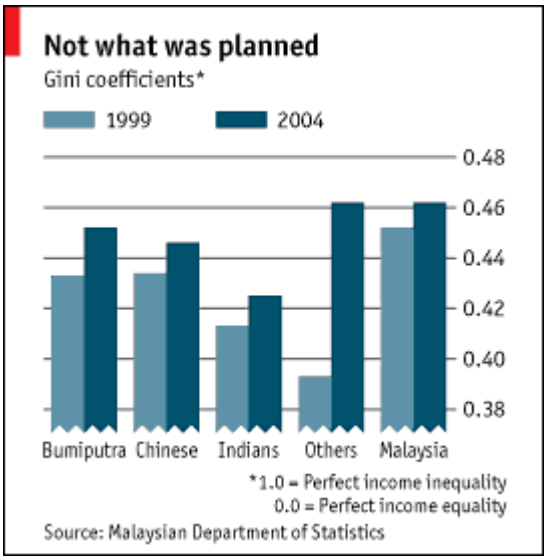
Far-sighted, but still with blind spots

MANY other middle-income countries do little more than dream of joining the rich world. Malaysia draws up elaborate plans on how to do it, and spends a fortune implementing them. In the early 1990s, the country set itself the target of reaching first-world status by 2020, and is well on its way. But when the prime minister, Abdullah Badawi, introduced a new, five-year "Malaysia plan" on March 31st, he gave warning that the road to riches will be steeper in future, given the competition from China, India and other fast-improving Asian neighbours.

The new plan puts less emphasis on grand infrastructure projects and more on the human side of development than earlier ones. Of its 200 billion ringgit ($54 billion) budget, the largest share, a fifth, goes to education. This reflects worries that, while China and India are churning out armies of technical wizards, its own universities produce rising numbers of unemployable graduates.

Previous plans did more for urban dwellers, but Mr Badawi promises a shift towards relieving poverty in the rural states of eastern peninsular Malaysia and Borneo. In a refreshing change, government help is being redirected towards states that do not vote for the ruling party, the United Malays National Organisation (UMNO). Mr Badawi has set himself tougher targets for cutting poverty: henceforth, households will be judged poor if their monthly income is below 691 ringgit, up from 588 ringgit. Even using the new figure, Malaysia's poverty rate has been slashed from 22.8% in 1990 to 5.7% now. But the intention is to halve it again, to 2.8%, by 2010.

The prime minister's grand plan would have been more impressive still had he taken the opportunity to scrap the expensive positive-discrimination policies, in force since 1970, that aim to help "bumiputra" (Malays and other indigenous races) catch up with Chinese and Indian minorities. Indeed, on top of the preferences Malays already enjoy in getting government contracts, shares in privatised firms and so on, Mr Badawi is adding a 2 billion ringgit fund to help them buy chunks of prime real estate. With official help, many Malays have done well. However, as in post-apartheid South Africa, which adopted a similar "black empowerment" policy, the result has often been "encronyment", with most benefits going to a well-connected few. Hence, Malaysia now has one of Asia's highest Gini coefficients, a measure of income inequality. As with other races, the gap between rich and poor Malays has widened (see chart).



Mr Badawi fears an UMNO backbench rebellion if he abolishes the party's most cherished policy. But Anwar Ibrahim, a former deputy prime minister,

now an opposition leader, says it must be scrapped, “for the sake of Malays and the nation”. The racial preferences deter foreign investment, of which Malaysia needs much more if it wants to get rich. So do corruption and unreliable courts, says Mr Anwar, lamenting the lack of more specific action against these in the new national plan. Mr Badawi says the economy must grow 6% a year if it is to reach its goal. Failure to tackle these problems has meant growth averaging only 4.5% since 2000.

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Japan's opposition

Floored

Apr 6th 2006 | TOKYO
From The Economist print edition

Vacancy: yet another new leader for the hapless Democratic Party of Japan

Reuters

Another one hits the tatami

ON APRIL 7th Japan's main opposition, the Democratic Party of Japan (DPJ), will get its fifth leader in as many years. Its fourth, Seiji Maehara, was elected only six months ago as a youngish, competent face after a miserable general election for the party in which the supposedly reformist DPJ opposed the reformist plans of the prime minister, Junichiro Koizumi, for privatising the postal-savings system. Mr Maehara announced his resignation last week, taking responsibility for a disastrous blunder in February when a colleague waved in parliament an e-mail that he thought was proof of money links between a disgraced internet company, livedoor, and a son of the secretary-general of the ruling Liberal Democratic Party (LDP). The e-mail that Hisayusu Nagata flourished turned out to be fake. Along with Mr Maehara, the DPJ's own secretary-general will also step down, and the blundering Mr Nagata is to quit politics.

Even without this farce, the party had struggled recently to convince the country that it is a viable opposition. According to a poll for the *Yomiuri Shimbun* newspaper, 69% of voters think the DPJ incapable of governing the country. Meanwhile, the absence of an effective opposition, political observers say, has costs for the country as a whole. Mr Koizumi claims to be pushing through many modernisations to government and the economy, but in the absence of an opposition to prod it along the push has slowed. Recently, for instance, Mr Koizumi has failed to stop taxpayers' money going towards building unneeded roads.

In foreign policy, a more cogent opposition would have been better at drawing attention to the neglect into which Mr Koizumi has allowed Japan's relations with its neighbours to fall. Mr Maehara was chosen to lead the DPJ in good part because of foreign-policy expertise, but he rarely seemed to score points. The televised afternoon in parliament in which Mr Maehara hoped greatly to embarrass the prime minister over the alleged livedoor e-mail turned into a humiliation as the old dog took the young puppy and shook him by the scruff of his neck.

That memory is now seared into the DPJ's collective consciousness, which is why it is looking for its next leader not among one of the younger generation of MPs clutching sheaves of position papers, but rather among the party's few grizzled heavyweights. The two chief contenders are Naoto Kan, 59, and Ichiro Ozawa, 63. Mr Kan, a patent lawyer, rose to prominence as a civic activist. Famously, as health minister in a coalition government in 1996, he exposed bureaucrats' cover-up of a scandal involving the spread of HIV-tainted blood. He has already briefly served as opposition leader, in 2002-04, but had to resign during a (relatively minor) scandal over pensions payments.

But as *The Economist* went to press, it was Mr Ozawa who appeared likelier to win the leadership. This will alarm those party members who pinned their hopes on an open, modernising DPJ. Mr Ozawa is a born backroom dealer who gathered power during a stellar career at the heart of the LDP. In 1993, when his growing number of enemies looked set to pounce, he defected, bringing about the LDP's only (if brief) fall from power in four decades. Mr Ozawa is outspoken in his hopes for a more assertive Japan, which appals the DPJ's many hard-core pacifists. Yet he is probably the only party man with the heft in public to take on the LDP heavyweights, of which, at heart, he remains one.

No matter who wins, DPJ politicians argue, the lesson of the recent calamities is that better party organisation and discipline are urgently needed. Motohisa Furukawa, responsible for the party's welfare policies, says that the e-mail crisis dragged on for far too long because “we have no war room, no crisis-management groups, no expertise in dealing with these kinds of challenges.” His colleague, Hirofumi Ryu, calls this a life-threatening moment for the party. “The next general election will be the last chance for us,” he says. Which is why members may have to swallow Mr Ozawa's appointment.

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India's defence industry

The private sector to the rescue

Apr 6th 2006 | DELHI
From The Economist print edition

Technology outguns bureaucracy

PLANS to open up India's defence procurement, allowing the country's dynamic private sector gradually to replace over-manned and inefficient government-owned defence corporations and ordnance factories, have been tossed around since 2002. But they made little real progress till March 29th, when the army authorised the award of two $20m contracts for rocket launchers to be used in its Pinaka missile system to two Indian engineering companies, Tata Power and Larsen & Toubro (L&T).

That is hardly a big arms order, but it is significant because it is the first time that private-sector Indian companies have been appointed as prime contractors on a defence project, however small, with overall responsibility for system integration. Tata and L&T began design work on the launchers for the government's Defence Research and Development Organisation (DRDO) as long ago as in 1989, but they have had to wait for their contracts till policy changes began to catch up with the army's needs for rapidly advancing technology—which the public-sector defence establishment could not meet.

Till now, defence integration work has been done by government corporations, with the private sector allowed only to supply a few components, or by overseas suppliers—especially Russia in the case of missile launchers and much else. About 70% of India's defence capital budget ($8.5 billion this year) is spent abroad because of the limitations of its public sector. The Indian private sector has been allowed only a marginal role, despite being formally given access to defence work in 2002, when foreign direct investment in defence companies was also allowed.

Since then, 28 manufacturing licences have been issued to 19 private-sector companies: but no prime contracts have been awarded until the Pinaka deal. During that time, only three small foreign joint ventures have been signed, partly because FDI equity stakes are being limited to 26% in most cases, though one of the three, between Snecma of France and government-owned Hindustan Aeronautics, has a 50-50 split on a $11m equity project. Most foreign defence contractors have felt little economic incentive to replace their currently lucrative supply contracts with manufacturing operations in India.

But that should also change in the near future, because of a government decision last year that 30% of the value of foreign defence contracts over 3 billion rupees ($66m) should be offset by purchases, investments and transfer of technology in India. This is intended to pull foreign defence contractors into joint ventures, especially companies from America—which wants the Indian government to award it large fighter aircraft, helicopter and other contracts—and other big suppliers in Russia, Europe and Israel. Eventually, this could boost India's currently tiny defence exports of under $200m a year, emulating the outsourcing success of India's information-technology companies.

“Like Israel, India has the right skills and low-cost design and testing capabilities to compete internationally,” says Rahul Chaudhry, chief executive of Tata Power's strategic-electronics division. Tata and L&T are hoping to follow their Pinaka contracts with tenders for work on a surface-to-air missile and a communication system for the army. They will be among ten to 15 companies that are to be selected by the government to compete as system integrators on equal terms with public-sector corporations. The private sector's ability to cope with rapid technological change should help India not only to fight enemies but to start shaking up its own bureaucratically protected public sector.

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China

The meter is ticking

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The revolutionary potential of cabbies

AP

Fuming

FOR China's disgruntled taxi drivers, these are worrying times. The government, long reluctant to raise fuel prices for fear of a backlash, has recently shown signs of yielding to the complaints of loss-making refiners beset by the high price of crude oil. In late March it announced the first retail-price increases in eight months. But is there a serious risk of protest?

Since March 26th the retail price of diesel has risen by more than 3% and gasoline by 5%. Increases were twice as high in Beijing, because of better fuel quality there. But the government is still being cautious. Prices remain well below international levels. A new windfall tax on crude-oil production introduced last week may have been aimed partly at dampening any public complaints. State oil companies have made big profits from oil extraction thanks to rising crude prices. State-controlled media quoted Chen Tonghai, the chairman of Sinopec, a state-owned oil producer and refiner, as saying that the tax could be used to boost subsidies for “weak communities” to offset price increases.

China worries about the impact of rising prices on a wide range of consumers, but peasants and taxi drivers are foremost among them. The Communist Party regards urban stability as particularly crucial to its grip on power. Although a car-owning middle class has expanded rapidly in recent years, it is taxi drivers who are particularly sensitive to price changes. In Beijing, whose stability is paramount, drivers of the city's 67,000 licensed taxis have much to complain about even without having to fret about fuel.

Drivers have suffered a big reduction in their disposable incomes over the last decade. A government-mandated consolidation of the industry beginning in the late 1990s has reduced the number of taxi companies and shifted ownership of taxis from drivers to these privately run firms. The companies profited massively by extracting ever higher monthly payments from drivers in return for granting them the right to drive (they cannot do so without company affiliation).

Guo Yushan of the Beijing Unirule Institute of Economics says drivers now earn around 1,500 yuan ($190) a month, a quarter of their incomes of a few years ago. And even to earn this they must work ten hours or longer a day with no days off. They, not the companies, have to pay for fuel, though since last year they have received a small subsidy.

The authorities worry that angry drivers could paralyse the city if they protested en masse. Beijing's public-transport system, though developing quickly, is still far from adequate. Fuel-price

rises in 2004 provoked taxi drivers to protest in at least 17 cities, according to Chinese press reports. Beijing taxi drivers believe that the government's fear of wildcat strikes is the main reason why they are not allowed to install two-way radio systems.

But Mr Guo argues that in Beijing, at least, there may be less reason for the authorities to worry these days. To ensure more compliant workforces, many taxi firms have started to hire migrants from rural areas around Beijing in place of native Beijingers. These migrants are often happy to have a chance to work in the city, where incomes—even those of taxi drivers—are much higher than in the countryside.

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Celebrity in China

Out of the dorm

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How to make Confucian communists squirm

Easy when you know how

HUANG YIXIN and Wei Wei, two students at the Guangzhou College of Fine Arts, were hanging around their dormitory last summer and decided—as one does—to turn on their webcam, put on their Houston-Rockets jerseys and lip-synch a few of their favourite songs by the Backstreet Boys. They uploaded the clips to Google Video, a free website full of such stuff. Their grimaces are over the top, self-consciously ludicrous. And they became famous almost instantly.

Astonishingly famous. Almost every Chinese internet user under a certain age has seen the “Back Dormitory Boys”, as they are now called. Web forums discuss their private lives. National radio and television shows have hosted them. Even their roommate, just visible in the background playing computer games, gets celebrity treatment.

Last month, a media company in Beijing called Taihe Rye hired Messrs Huang and Wei to continue their lip-synching, for cash. Song Ke, the boss, says that he has already placed his clients in a television commercial to be filmed next month for Pepsi Cola, one of China's largest advertisers. The plan, says Zhao Qian, another manager at Taihe, is to put the Back Dormitory Boys together with their idol, Yao Ming, a Chinese basketball prodigy who plays centre for the Houston Rockets. Messrs Huang and Wei will thus join the company of such global celebrities as David Beckham, Ronaldinho Gaucho and Janet Jackson as a public face of Pepsi in China.

To some of China's professors and cadres, all this is further confirmation, if any were needed, that the country has taken a worrisome turn. They had barely recovered from Sister Lotus, a young lady who published provocative photos of herself online in order to find love only to find fame instead, at least until the government censored her. Then came that other grassroots celebrity (also a Taihe client), Li Yuchun, a boyish-looking girl who became champion on “Super Girls”, a

television show that lets viewers vote for their favourite star, who also unleashed potentially worrying amounts of enthusiasm for voting. And now the Back Dormitory Boys. The phenomenon indicates a modern social illness, says Pan Zhibiao, who is vice-president of the Guangdong Provincial Society of Aesthetics, and thus, of course, an expert in such matters.

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Morocco

In his father's shadow

Apr 6th 2006 | CASABLANCA AND RABAT
From The Economist print edition

Morocco's faltering transition to democracy under King Mohammed VI

AP

FOR visitors to Morocco's twin capitals—one political, the other economic—it is hard not to think that they represent the exception to the political decrepitude that seems to plague the Arab world. The bright mimosas and bougainvilleas of Rabat and the bustling business centre of Casablanca form a striking contrast with the dreary shabbiness and laissez-aller encountered elsewhere in the region. So does the political atmosphere: where else do truth and reconciliation commissions discuss torture cases on public television, or newspapers publish critiques of a head of state along with details of his private finances, or women live (at least on paper) under a more progressive family law?

“Morocco is advancing at a slow pace, but it will get there in time,” says one Western diplomat. “It's a model for reform—the best we have in a bad neighbourhood.”

For most Moroccans though, the point of reference is not Algeria's brutal military oligarchy or Tunisia's police state. It is not even “*les années de plomb*” (the years of lead) of the 1970s and 80s when political repression in Morocco was at its fiercest. Rather, it is the expectation of democratic transition first promised by the late king, Hassan II, in the early 1990s and reinforced by Mohammed VI's accession to the throne in 1999. But, despite some important milestones, Moroccans remain dissatisfied. For some, the country is democratising too fast, straight into the hands of Islamists eager to impose a reactionary moral order. For others, a cabal of former royal schoolmates in key public posts is simply exploiting Morocco's slowly liberalising economy for their

own ends.

The harshest critics say that the reform process is a lure—a distraction from the fact that power is still concentrated in the hands of one man and abused by a coterie of technocratic yes-men. “They swindled us,” laments Abou Bakr Jamai, editor-in-chief of Morocco's most irreverent magazine, *Le Journal Hebdomadaire*: “Mohammed VI had enormous political capital when he began. But he squandered it.”

In February, Mr Jamai was sentenced to pay the largest fine ever imposed in a Moroccan libel case after he alleged that the government had paid a Brussels think-tank to produce a pro-Moroccan report on the Western Sahara conflict. Another French-language weekly, *TelQuel*, was likewise sued for libel—twice—and given disproportionate fines shortly after publishing articles critical of the monarchy, though the matters were officially unrelated. The Moroccan judiciary is notoriously subservient to the crown.

The most egregious example of this judicial *revanchisme* is the case against Nadia Yassine, daughter of the leader of a banned Islamist group, Adl Wal Ihsane (Justice and Charity). She is on trial for insulting the monarchy after making an off-the-cuff comment to a magazine asserting that Moroccans “would not die if we didn't have a king”. The media-savvy Ms Yassine is now using the trial to publicise her fierce criticism of the regime, denouncing its “superficial democratic reforms” and advocating her Sufi-inspired brand of Islam “as an antidote to violence”. She is demanding the abolition of Article 19 of the constitution enshrining the king's role as Commander of the Faithful.

Ahmed Benchemsi, *TelQuel*'s editor-in-chief, is more sanguine about the considerable reforms achieved, seeing the occasional backlash as par for the course. But he remains worried. “The monarchy doesn't understand that it needs to democratise for its own sake,” he says: “The status quo is not sustainable.” Moroccans feel frustrated. The high hopes they had in the new “king of the poor” have not materialised. Despite progress, Morocco is still an absolute monarchy where dire poverty coexists alongside lavish wealth. An average growth rate of around 5% over the past five years has done little to create jobs or alleviate the plight of the poorest.

Almost daily, unemployed graduates protest in front of parliament to demand government jobs which, although low paid, are at least secure. In December, several students set themselves on fire, screaming “a civil-service job or death”. None actually died, but many were badly burned. A failing education system does little to prepare Moroccans for life in the private sector. A landmark education law, aimed at remedying the situation, was passed in 2000. But it has never been implemented. The opposition from teachers' unions and other entrenched interests was too strong. Politicians are generally seen as either unwilling or unable to carry out reforms without the king leading the way.

Even the current favourite to win next year's parliamentary elections, the Islamist Justice and Development Party (PJD), plays by the rules of *ba'ya*, the traditional pledge of allegiance to the monarchy. So far, the party has offered few new ideas to distinguish itself in the political field. Its most innovative contribution to the economic debate has been to suggest that Morocco specialise in tourism and retirement homes for European pensioners rather than seeking to attract young (and morally lax) travellers.

A similar lack of imagination marks the intractable dispute over the Western Sahara. Reformists have long argued that a large degree of autonomy for the region within a more decentralised and democratic Morocco would give the government a powerful argument against Sahrawi secessionists and their growing number of international supporters. Ahead of this month's UN deadline for the resumption of the stalled peace process, the king asked all political parties for their views on how to solve the conflict. Predictably, they reiterated the king's own vague ideas for

limited regional autonomy. Even on such a crucial question, all eyes look to the king, either to assign blame or to provide an impetus for change.

By keeping most of the levers of power in his hands, King Mohammed has perpetuated the emasculation of the body politic established by his father. The king, and not the government, controls the ministries of defence, foreign affairs and the interior as well as countless commissions and authorities. He is the country's most important farmer, biggest banker and most active venture capitalist. Most of the innovative ideas over the past few years—the Equity and Reconciliation Commission's investigation into human-rights abuses under King Hassan, an ambitious human-development initiative designed to eradicate poverty, a report marking last month's 50th anniversary of Moroccan independence that offered an unprecedented independent critique of government policy —have been royal projects.

In countless public buildings, cafés and shops, gold-framed portraits of King Hassan still dwarf those of the present monarch. In the 1990s, Moroccans eagerly awaited Mohammed's accession, hoping he would usher in a real transition to democracy, as had Spain's King Juan Carlos, just across the straits of Gibraltar, two decades earlier. Morocco has no blueprint for its transition. The king is a notoriously bad communicator, granting few interviews and seeming ill at ease when delivering royal speeches. A Juan Carlos may have been a bit too much to expect, but Moroccans would at least like a clear a vision of future governance—if only to know where they stand.

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Charles Taylor

A big man in a small cell

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The former Liberian president is finally behind bars

AFTER three years on the run, Charles Taylor, African warlord turned president, finally appeared in a UN-backed court in Sierra Leone on April 4th, charged with 11 counts of crimes against humanity and other serious violations of international law. Dressed in a smart dark-blue suit and red tie, he defiantly challenged the power of the court to try him, before agreeing to plead not guilty to all charges. He is accused of being the “co-perpetrator” of heinous atrocities carried out by the rebel group he backed during Sierra Leone's 11-year civil war, including hacking off limbs, conscripting child soldiers, cannibalism, gang rape and sexual slavery.

Five days earlier, the former Liberian president had cut a much sorrier figure when he stepped off a UN helicopter, handcuffed and bedraggled, in Sierra Leone's capital, Freetown. Whisked through streets of cheering crowds, happy to see their once all-powerful tormentor brought low, he was taken straight to his cell within the heavily guarded court compound. It marked the end of three years of luxurious exile in Nigeria. It could also mark the beginning of the end of impunity for African “big men” who have hitherto largely escaped punishment by their peers for fear of creating a dangerous precedent. Mr Taylor is the first African head of state to be indicted for crimes against humanity.

For security reasons, the trial may be transferred to The Hague. Mr Taylor, who made vast sums of money smuggling Sierra Leonean “blood diamonds”, still exerts considerable influence in the region, particularly in Liberia, where many of his supporters are now in power and where he continues to finance and arm at least one armed militia. Liberia's new president, Ellen Johnson-Sirleaf, fearful that her country might be plunged back into civil war, is among those calling loudest for the trial's transfer.

Run jointly by the UN and Sierra Leone's government, the Special Court likes to boast that it is the first international war-crimes tribunal since Nuremberg to be set up in the country where the crimes took place. Nine of the people believed most responsible for the atrocities are already on trial there. But the court's statutes also provide for hearings “out of theatre” if so mandated by the Security Council. A draft UN resolution is now circulating and could be approved by the end of the week.

But though the Netherlands has agreed in principle to host the trial (in the premises of the International Criminal Court in The Hague), it is insisting that a country first be found that is willing to host Mr Taylor after (or if) he is convicted. The United States, where Mr Taylor was educated and where his son lives, together with a number of European countries have come forward as possibles. But no African country has shown any willingness to offer him hospitality, even behind bars.

Mr Taylor's “spiritual adviser” originally suggested that the former Liberian leader would himself

prefer to be tried in The Hague. But his lawyers now say he wants to remain in Freetown in order to be close to his family. A more likely reason is that he feels, however unlikely, that he has a better chance of organising a rescue operation if he remains: he has already escaped from prison before, while in America in the 1980s. He might also believe that, with his vast wealth, he could influence next year's election in Sierra Leone, in the hope of bringing to power a government that would look favourably on his release.

Some civil-rights groups are nevertheless urging that the trial take place in Sierra Leone. The whole purpose of having tribunals “in theatre” was to bring the proceedings closer to the victims, they say. There would also be the huge extra cost of transferring the proceedings—judges, witnesses and officials—to the much more expensive Netherlands. The Special Court relies on voluntary donations from UN member states, and is already finding it difficult to raise enough to cover its modest annual budget of $25m. All these issues have yet to be worked out. Meanwhile, let the world rejoice that it finally has got such a monster behind bars. Few ever believed that it really would happen.

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Iraq

The wild west

Apr 6th 2006 | BARWANA AND RAMADI
From The Economist print edition

A tiny hope, and thick gloom, in Anbar

AT THE din of an approaching helicopter, Sergeant Ken Brown drags $750,000, crammed into three white sacks, onto a dark Baghdad landing strip. He is bound for Qaim, the westernmost town of Anbar province, to pay 1,900 unhappy Iraqi soldiers. Some have not been paid for four months and are threatening mutiny.

In Anbar's recent history, this is progress. Six months ago, Qaim, and half a dozen other towns along the western Euphrates valley, were ruled by head-chopping al-Qaeda fanatics. They had no Iraqi security forces (ISF), and saw only occasional, very violent, appearances from the American marine division in Anbar.

The militants had controlled the area, with its convenient rat-runs into Syria, since late 2004, when the marines were concentrated on another rebellious Anbar town, Falluja. Their grip was loosened last October and November by a series of American raids that involved up to 2,500 marines and 1,000 ISF in the biggest American operations in Iraq last year. Now, in Qaim and nearby, there are Iraqi soldiers and emerging local councils. Though the marines and the ISF are still very often attacked, by road-side bombs and small-arms fire, they have brought at least a promise of government control.

Across Iraq's biggest province, the size of Belgium, American officials see other causes for hope. Anbar's 1m Sunni residents remain fiercely opposed to American occupation and, as they see it, the Shia ascendancy this has brought. According to a recent poll, 88% of Iraq's Sunnis support attacks on American troops and only 13% approve, with hindsight, Saddam Hussein's removal. Yet Anbaris are now more prepared to give non-violent politics a chance: 86% voted in last December's election, up from 2% 11 months earlier. Tribal and religious leaders are also more willing to talk to the Americans. In Ramadi, the provincial capital, local chiefs met senior American officers last December—the Iraqis demanding that the Americans leave their city, the Americans requesting co-operation to help them to do so.

Better still, senior Americans and Iraqis claim to have found a growing revulsion in Anbar with the methods of the Islamist fanatics. In January, a suicide bomber attacked one of the first police-recruiting sessions in Ramadi since the city's police collapsed two years ago. Sixty local men were killed. Yet more than 1,000 recruits have since come forward. The marines even claim to have seen fighting between townspeople and Islamist militants. According to recent reports, Abu Musab al-Zarqawi, the Jordanian boss of Iraq's al-Qaeda franchise, has lost support, even within his movement.

Encouraging as they are, these signs suggest an opportunity for improvement, rather than much actual improvement. Western Anbar's raids killed many militants, but are not believed to have broken their groups. According to a study by Anthony Cordesman of the Centre for Strategic and International Studies, they “taught the insurgents how to disperse, be less vulnerable and use other patterns of attack.”

Anbar is Iraq's most violent province save Baghdad, with about as many insurgent attacks as before the election. And though its ISF are improving, they remain fewer and frailer than elsewhere: Almost Anbar's only trained police, for example, are the 1,200 in Falluja, the marines' headquarters. In many small towns, where policemen were killed or driven away by insurgents in 2004, the Americans are now recruiting from tribes with a grudge against the insurgents. The United States has set itself to recruit and train 11,300 Anbari police by the beginning of 2007. Despite the encouraging recent recruiting in Ramadi and elsewhere, it would probably be pleased with rather less.

Even so, better security forces are only part of the solution to Anbar's violence. The province is estimated to have 200,000 unemployed, bored and resentful, military-aged men. Because of its insecurity, it has received little reconstruction money, with less than $230m-worth of completed projects. In Barwana, a pleasant huddle of hilltop and riverside hamlets, commerce has been strangled since the marines closed the border with Syria during their operations last year and destroyed several bridges to restrict their enemies. Local men needing money to marry are easily hired by insurgents to shoot at Americans.

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Iraqi politics

Blocked in Baghdad

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From The Economist print edition

Nearly four months after the election, still no government

IT'S all there in “King Lear”, the dilemma in Iraq. If you give your power away, you don't have it any more. So when Condoleezza Rice, the American secretary of state, flew into Baghdad last weekend with Jack Straw, Britain's foreign secretary, in tow, they failed to get what they wanted.

What they want, nearly four months after Iraq's general election last December, is a government, and especially one that includes all three main sectarian groups, the Shias, Sunnis and Kurds. But attempts to form a coalition have been fatally hampered by quarrels over the person the biggest block—the Shia-dominated United Iraqi Alliance—has nominated as its candidate for prime minister, Ibrahim al-Jaafari.

Dr Jaafari has an unusual mix of defects. He is not a big personality: in his first stint as prime minister, in charge of the interim regime that drew up Iraq's new constitution, his main characteristic was passivity. Nor, though, is he much of a conciliator: the Kurds, in particular, distrust his intentions over the oil-rich province of Kirkuk. But nor, despite his dull and generally passive public persona, is he a push-over.

After Ms Rice pushed in Baghdad for “a prime minister who can form a government”, Dr Jaafari pushed back. He told Britain's *Guardian* on April 4th that the democratic idea America and Britain had tried to implant in Iraq disqualified them from saying who its prime minister should be. “People will react if they see the rules of democracy being disobeyed,” he said. “Everyone should stick to democratic mechanisms no matter whether they disagree with the person.”

There's George Bush's freedom agenda for you. Hopes of a new government now depend more on the opaque machinations of Shia politics than on America and Britain. Another Shia politician, Adel Abdul al-Mahdi, said this week that Dr Jaafari should step aside. Ms Rice and Mr Straw plainly hope that the supple Mr Mahdi will take the place of the stubborn Dr Jaafari—even though Mr Mahdi is closer to Iran. Hard times make for strange bedfellows.

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France

A tale of two prime ministers

Apr 6th 2006 | PARIS
From The Economist print edition

As the government waters down its labour reform, the prime minister, Dominique de Villepin, loses authority to rivals, such as Nicolas Sarkozy

AFP

FOR a country that prides itself on its Cartesian logic, France has recently taken a decidedly baroque turn in its politics. First, President Jacques Chirac intervened in the country's bitter eight-week-long clash over a new job contract for young people under 26. His bizarre solution? To permit the controversial bill creating the new contract to go into law, but to urge his fellow citizens to pay no attention to it until it was amended.

Next, and equally baffling to a French public that has grown used to seeing parliament treated as a mere rubber stamp, Mr Chirac handed authorship of a new law to amend the contested one not to the prime minister, Dominique de Villepin (above, right), but to the UMP party, whose leader is the interior minister, Nicolas Sarkozy (left). “It is time”, the president concluded in a televised statement watched by some 21m viewers, “to resolve the situation.”

By the middle of this week, that promised resolution had bred only confusion. The stand-off between the government and protesters continued in the streets. On April 4th, in another day of strikes and demonstrations, 1m-3m people—as many as the week previously—marched around the country. They are continuing to demand the complete withdrawal of the *contrat première embauche* (CPE), designed by Mr de Villepin in a bid to encourage job creation. This was the law that Mr Chirac decided to promulgate, after the Constitutional Council, France's highest court, had ruled that it was perfectly constitutional.

Political authority in France is now in a state of flux. A resolute Mr de Villepin continued to insist this week that he “will not give up”. But his position has been seriously undermined. He is no longer in charge of the law he originally drew up. Bernard Accoyer, head of the parliamentary group of the UMP, along with his counterpart in the Senate, is now drafting a new one to meet Mr Chirac's two main demands for change: a halving of the CPE's two-year probation period, and a requirement that employers must justify any redundancy. In a dramatic power shift, it was Mr Accoyer who this week invited union leaders to talks. Mr de Villepin did not even attend. “Mr prime minister, who governs France today?” taunted Jean-Marc Ayrault, leader of the Socialist group in the National Assembly.

The humiliation for Mr de Villepin is acute. By promulgating the law, Mr Chirac hoped to help his prime minister to salvage some credibility. He may also have been trying to thwart any thoughts of resignation: if the street brought down a government only a year before the next presidential election, it could crush the rest of his presidency as well as the prospects for the political right. Yet it is hard to see how Mr de Villepin can push any other reforms in the run-up to the 2007 presidential election, let alone plausibly mount his own bid. His popularity has fallen by 14 points over the past month, to just 28%, says a BVA poll for *L'Express*. As for Mr Chirac, 62% of those who watched his TV address judged it “unconvincing”. A “calamitous fin de règne”, commented *Le Monde*.

Who will emerge strengthened from this saga? Top of the list stands the trade-union movement. In the past, it has been split by fratricidal disputes. The previous government of Jean-Pierre Raffarin managed to push through a pension reform against union resistance largely because it won the support of the CFDT, a more moderate group. This time, the five main unions, along with those representing students, have been rock solid in insisting on the withdrawal of the CPE, which is now part of French law but which many deputies already refer to as dead.

Indeed, flush with their success, some union leaders (as well as the opposition Socialists) are now demanding the abolition of another more flexible job contract previously introduced by Mr de Villepin. The Socialists too have been capitalising on the government's troubles; in the past month alone, they have signed up an extra 18,000 members.

The biggest uncertainty, however, concerns Mr Sarkozy, Mr de Villepin's main rival as presidential hopeful for the centre-right. As head of the UMP, he seemed to interpret this week's shift of power to the parliamentary party as carte blanche to take charge. No sooner had Mr Chirac spoken than Mr Sarkozy reminded the public that “for several weeks, I've been calling for a compromise.” To the consternation of the prime minister's supporters, he spent the weekend telephoning union leaders personally, urging them to return to negotiations. “Sarkozy, the other prime minister,” ran a banner headline at *Le Parisien*.

Mr Sarkozy may yet be hauled back into line. But, so far, public opinion seems to approve of his efforts. While 70% told a CSA poll that Mr Chirac had emerged from the crisis weakened, and 75% thought Mr de Villepin had, only 30% felt the same about Mr Sarkozy. If he can help to bring about an end to the street protests, his stock could rise still further. On April 5th he called for constitutional change in response to what he described as the exhaustion of France's political system.

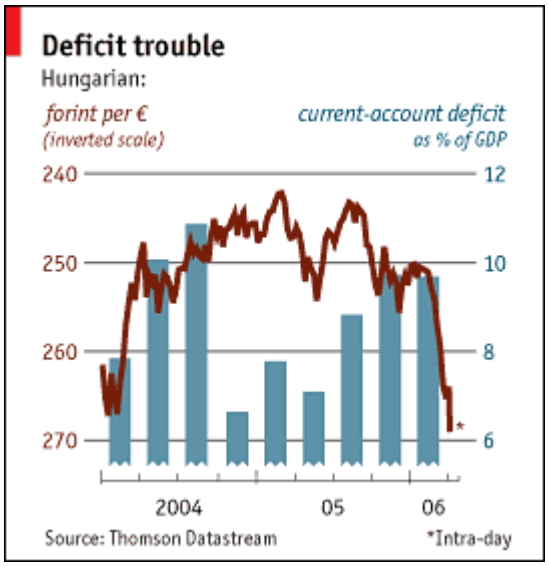
The big difficulty for Mr Sarkozy will be to square the impression of yielding to the street with his advocacy of a “rupture” with the bad old ways. In the past, Mr Sarkozy has consistently pushed for an even bolder liberalisation of the labour market than Mr de Villepin has even dared to propose. Indeed, he favours a single, more flexible job contract for all, to bring an end to France's two-tier labour market. If the new law ends up rendering the CPE meaningless, with no concessions extracted from the labour movement in return, it will hardly amount to a convincing demonstration of his reformist credentials.

Hungary's election

Sense and nonsense

Apr 6th 2006 | BUDAPEST
From The Economist print edition

The politicians promise everything, but will find life harder if they win



BOTH sides talk nonsense in public while promising in private to be sensible. That, in brief, is Hungarian politics in the run-up to the first round of parliamentary elections on April 9th.

Looking at the government, spendthrift and sleazy, it is easy to see why the opposition is cross. The Socialist-liberal coalition has presided over the worst mismanagement of public finances anywhere in post-communist Europe. Officially, the budget deficit is 8% of GDP. Including off-balance-sheet financing, it is more like 10%. That has helped to stoke a huge current-account deficit, and has now sent the forint to a 28-month low (see chart).

Most damage was done in the government's first two years, in a bid to reward its supporters. As one finance minister from a neighbouring country comments, “I can understand why they made these idiotic promises, but not why they kept them.” When Peter Medgyessy, who became prime minister in 2002, turned out to have a background in communist-era intelligence, that was too much to swallow even in Hungary's forgiving political culture. So in 2004 in came Ferenc Gyurcsany, a tycoon who combines capitalist credentials with family links to the old regime.

Asked to list his practical achievements in the past two years, his supporters look faintly baffled. Their big feat, they say, has been staying in power and getting ready to win the election—which, according to Hungary's often unreliable polls, they seem likely to do. The Socialists are polling around 46%, and, crucially, their small coalition partner, the leftist liberals, seems likely to get over the 5% threshold necessary to enter parliament.

That will be a huge disappointment for the opposition Young Democrats (usually known, by their Hungarian acronym, as Fidesz) and their leader, the outspoken Viktor Orban. Mr Orban has impeccable credentials as a brave and effective communist-era dissident. But he has moved sharply away from the radical liberalism of his youth, in a conservative, nationalist and populist direction. Many Hungarians' discontent with the government tends to evaporate as soon as they look at the opposition.

Mr Orban's campaign has been gaffe-strewn, and his programme is peppered with expensive spending commitments, including bigger housing subsidies. He rails against “luxury profits” and rapacious foreigners, though he insists also that he wants “a country with less bureaucracy, a pro-

business government and lower taxes.” His public speeches, though, more often feature lines such as this: “Grant us...a national government in Hungary, which sees the world through Hungarian eyes, thinks with a Hungarian mind and senses in its heart a Hungarian beat.”

That could just be a robust yet defensible bid to appeal to patriotic voters. But others hear a cynical, demagogic appeal to revanchism and xenophobia. Some also charge Mr Orban with coded anti-Semitism. He strongly denies this; so do his Jewish colleagues. Even so, his colourful election tactics put one question-mark against Mr Orban's suitability for office.

His record raises another. His previous stint as prime minister, until 2002, showed mixed results. He ran the economy well—until a vote-grabbing binge in the final year. Hungary gained NATO membership and moved fast towards the European Union. But relations with the neighbours were scratchy. Fidesz still hankers after justice for the Hungarians deported from neighbouring countries after 1945. “Sooner or later, they have to pay,” says one senior figure, “200,000 Hungarians were expelled and lost all their possessions.” That contrasts sharply with the present government's emollient foreign policy of being friends with everybody.

In private, both parties say much the same things: in the short term, there must be fiscal tightening and, thereafter, radical public-sector reform. The first, particularly, will be an unpleasant shock for Hungarians, who have got used to living well but dangerously on borrowed money.

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A better Bosnia

Rebranding time

Apr 6th 2006 | SARAJEVO
From The Economist print edition

A new proconsul talks up his country

HARI VARESANOVIC and Christian Schwarz-Schilling make unlikely allies. The first is a lead singer in a Bosnian pop group called Hari Mata Hari. The second is a 75-year-old German former cabinet minister, who is now the international proconsul in Bosnia-Hercegovina.

Both men think that the country has got a bad name and that it needs better publicity. Hari, as he is known, will represent Bosnia in next month's Eurovision song contest. Last month he had dinner with bankers and industrialists in Sarajevo to raise money for concerts for the Bosnian diaspora in Germany and Sweden. The moneymen were ready enough, in the hope that they can raise Bosnia's chances of winning, thereby bringing the lucrative competition to Sarajevo in 2007.

Mr Schwarz-Schilling frets that people link Bosnia only to racketeering and people-trafficking. He says the country has done a poor job of trumpeting the progress of the past few years. “How are we to improve the economic climate,” he asks, “if people associate the country with organised crime? Who will come?” The economy is top of his agenda. If foreign investors are slow to come to Bosnia, he thinks Bosnians should go to them. Recently he took a group of Bosnian entrepreneurs to a Hanover technology fair that he helped to found in 1986. “If you don't know which possibilities exist, you cannot go out and take advantage of them,” he says.

Mr Schwarz-Schilling is doing the job that Britain's Lord Ashdown did for over three years. The so-called high representative has huge powers in Bosnia, which derive from the Dayton peace agreement that ended the war in 1995. Lord Ashdown used those powers to the maximum. His successor says that he will use them only if there is a threat to the peace, or over suspects such as Radovan Karadzic and Ratko Mladic who have been indicted by The Hague war-crimes tribunal.

In fact Mr Schwarz-Schilling has a very odd job. He insists that he will not interfere in the daily running of Bosnia; indeed, he hopes that the post of high representative will be abolished early next year. But that will not mean that he slips into quiet retirement. Far from it—for he also has a second role, to represent the European Union in Bosnia. That will become more important when the post of high representative goes: for it is then assumed that Bosnia's fractious leaders can continue to be cajoled into reforming their dysfunctional state via pressure from Brussels.

The Dayton peace agreement succeeded in ending the country's war a decade ago. Now Bosnia is made up of two entities, plus the autonomous district of Brcko. Last month the leaders of seven of

Bosnia's main parties agreed to make modest constitutional changes (though these could be stalled in parliament). They also agreed to work for bigger changes after the elections that are due in October.

Among Sarajevo's intelligentsia, Lord Ashdown's heavy-handedness was unpopular. Now some find Mr Schwarz-Schilling's hands-off approach equally alarming. Noting that Bosnia's politicians “will never do anything” without pressure from outside, Senad Slatina, at the Centre for European Integration Strategies, a think-tank in Sarajevo, argues that, before Mr Schwarz-Schilling gives up his coercive powers, “there is a lot to be done.”

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Greece's foreign policy

Dora's dreams

Apr 6th 2006 | ATHENS
From The Economist print edition

A well-connected foreign minister treads warily with her cousins

AP

Bakoyiannis presents her credentials

AS A tall, striking scion of a famous political dynasty, the newish Greek foreign minister, Dora Bakoyiannis, seems well-placed to give the country's diplomacy a panache it lacked under her 77-year-old predecessor. Her profile as a centre-right politician with a power base of her own rose during her previous job, as mayor of Athens. Besides hosting the 2004 Olympics, her achievements included a professional audit of the city accounts, and securing a promise of European Union money for a giant leisure centre, with a stadium for the Panathinaikos football team. On the foreign front, the friendship between the Mitsotakis family, into which she was born, and America's Bush family has done her no harm.

But none of these assets make it easier for Mrs Bakoyiannis to handle the issue which, as she said this week, still tops Greece's external agenda: Cyprus. As mayor, she was among the Greek politicians who lamented their Cypriot cousins' rejection, in a 2004 referendum, of a UN plan to reunify the island. Her appointment as foreign minister was greeted warily in Nicosia. But on starting her new job, she sent a message to Tassos Papadopoulos, the Greek-Cypriot president, reassuring the island's rejectionists: she now saw the UN plan as “history”.

On her first visit to Cyprus this week, Mrs Bakoyiannis put more emphasis on sending pan-Hellenic signals to Turkey than on urging the Greek-Cypriots to be flexible. Both the Greeks and their Cypriot kin are stressing two things that Turkey must do to keep its EU hopes on track: recognise the Greek-Cypriot government, and allow Cypriot ships into Turkish ports. Mr Papadopoulos faces little pressure from Greece to take risks for a settlement. The UN is trying harder: Kofi Annan, the secretary-general, has urged the two sides to hold “technical” talks that might lead to more substantial negotiations.

From a Greek viewpoint, it may be enough if Mr Papadopoulos can be induced to sound just

flexible enough to avoid being called intransigent by other EU members. Nor does the Greek-Cypriot leader need to worry about his own voters. In the parliamentary election on May 21st, parties opposed to the UN plan are expected to do well. Most depressingly, for advocates of reunifying the island, a recent opinion poll suggested that 48% of Greek-Cypriots preferred to go on living separately from the Turkish-Cypriots, whereas only 45% favoured co-existence. Among the young, the proportion in favour of separation was even higher.

With the Cyprus issue rumbling in the background, the ardour of the personal friendship between the Greek and Turkish prime ministers has also cooled in recent months. Only in the business world (see article) are ties between the two countries still booming.

Mrs Bakoyiannis has family memories of her own that may hold her back from urging a softer line on the Greek-Cypriots. Some 25 years ago, when her father, Constantine Mitsotakis, was Greek foreign minister, he was pelted with eggs by hard-line Greek-Cypriots on arrival at the island's airport. These days, with two years of experience in the EU, the Greek-Cypriots use more subtle techniques to deal with Athens. For better or worse, Mrs Bakoyiannis has less clout in Nicosia than her predecessors did.

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Spain and corruption

Costalot

Apr 6th 2006 | MARBELLA
From The Economist print edition

A corruption scandal involving property engulfs a Spanish resort

THE brash, ritzy Spanish Mediterranean resort of Marbella has always been fond of the limelight. Arab potentates, film stars, sports celebrities and on-the-run crooks have all come to this booming party town on the Costa del Sol over the past two decades. Now, however, it is getting attention it does not want: as a capital of Spanish municipal corruption.

A magistrate has locked up the mayor, the deputy mayor and nine other people. Spain's Socialist government is taking the unprecedented step of dissolving the town council. Administrators will be sent in to run it. The property seized includes 200 fighting bulls, 103 thoroughbred horses, 275 works of art, plenty of jewels, a helicopter and four Porsches.

The mess in Marbella has exposed a problem that some Spaniards fear reaches other places. The long Spanish construction boom, especially along the Mediterranean coast, has brought an explosion in the money that town halls take in from issuing building licences. Juan Sánchez, the mayor of nearby Casares, estimates that some municipalities now get as much as 70% of their income from this source.

Yet what could be a sensible way of financing local development got out of hand in Marbella. Additional under-the-counter bribes became a routine part of town-hall business, say investigators. The magistrate claims that the mayor, Marisol Yagüe, was a “puppet” in the hands of developers. Her deputy “charges for everything”, he added, in a document obtained by Spanish newspapers. Even the local police force is reported to be rotten with graft.

It is not just Marbella's reputation that has suffered. Many of its building licences have now been challenged by higher authorities. Some 37% of the town's 80,000 houses and apartments are in legal limbo. Property owners, including many northern European sun-seekers, worry that their homes might be bulldozed.

Is Marbella a one-off, as other Spanish mayors insist? Or could similar rot be found in other places? Spaniards have reason for concern. The mayor of Manilva, just down the coast from Marbella, is awaiting trial on charges of involvement in a €250m ($300m) money-laundering ring. A former mayor of Estepona was convicted on similar charges.

The truly disturbing thing about this scandal is that nobody was surprised. Rumours of rampant corruption stretch back at least 15 years, when a populist construction magnate, Jesús Gil, became Marbella's mayor. Local voters were not bothered. They re-elected him twice.

In a report written three years ago, researchers at the Criminology Institute at Malaga University said something was wrong. “It is sad that we have got to this stage, when it could have been stopped before,” says the institute's Alejandra Gómez-Céspedes. Gil died in 2004. But his former

planning adviser, Juan Antonio Roca, is at the centre of the new scandal.

Like all those arrested, Mr Roca pleads his innocence. “This government does not tolerate, nor will it tolerate and much less support corrupt behaviour,” thundered the deputy prime minister, María Teresa Fernández de la Vega, after a special cabinet meeting in Madrid to discuss Marbella. Spaniards and other Europeans may feel they need more evidence to back up that claim if they are still thinking of buying a property in the sun.

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German music

From Bayreuth to Theresienstadt

Apr 6th 2006 | NEUHARDENBERG
From The Economist print edition

Assessing the musical heritage of the Nazis

GERMAN baby-boomers are rediscovering the dance music of the Weimar Republic. But few have a clue about artists during the Third Reich. This may change, thanks to an exhibition that documents the central role that music played between 1933 and 1945. Conceived in France, it is now on view at Neuhardenberg, a castle near Berlin.

As is well known, the Nazis tried to eradicate music they deemed “degenerate”, or *entartet*. In 1938, the cultural bureaucracy even organised a show to denounce jazz music, not least because it featured such “un-German” things as saxophones and syncopation. Yet the limited success of such propaganda forced the regime to be pragmatic, allowing jazz to be played even on the radio.

That did not help Germany's numerous Jewish musicians and composers, however. First, they were excluded from its musical institutions. Those who did not have the money to leave the country were later deported. Many ended up at Theresienstadt, where they were forced to give concerts, because the concentration camp north of Prague was supposed to be a showpiece for the Nazis' racist policies.

It is less well known that music was crucial to Nazi ideology. Hitler considered himself inspired by it. There was Wagner, of course: “Rienzi”, an opera about a courageous Roman leader, is said to have inspired the Führer's idea of having a mission to lead the German people. But there was also Anton Bruckner, an Austrian composer, with whom Hitler identified so much that he sometimes called him Adolf Bruckner.

Music was also used as a tool to legitimise the regime. Celebrating Germany's musical heritage, from Bach to Beethoven, led people to believe they had a special affinity for music. The Nazis built an extensive musical infrastructure, with concerts and singing made into a part of daily life. During the war, music such as “Lili Marleen” was used to motivate soldiers at the front and boost morale at home.

Where the exhibition falls short is in showing what happened after 1945. Many musicians continued their careers undisturbed. And the Nazis' influence on music is still felt. It is one reason why younger Germans often prefer foreign music—and have rejected some of their own, such as folk music and *Schlager*. But this, too, is changing. Never before have bands singing in German been as popular as they are now. More disturbingly, rock music is now the preferred choice of neo-Nazis seeking to appeal to youngsters. Goebbels, also a music fanatic, would have approved. “We don't live in the Biedermeier period”, he once said, “but in a century whose melody is determined by the thousand-fold buzz of machines and roar of engines.”

Charlemagne

Stability v flexibility

Apr 6th 2006
From The Economist print edition

Another sorry chapter in Europe's chronicle of unintended consequences

IN THEIR effort to run caring, efficient societies, European countries combine extensive state intervention in labour and other markets with a strict self-denying ordinance in fiscal and monetary affairs. This combination sounds reasonable. The first sorts of measures embody the kinder, gentler qualities of Europe's "social model"; the second limits financial irresponsibility and should thus safeguard the model's long-term viability.

If only. The reality, as evidence from France and Germany is showing, is that European governments seem to have to choose between fiscal and monetary stability on one side, and reforms to make their economies more flexible on the other. And they often choose to deal with the public finances first. As a result, their overall reform effort is weaker than it should be.

It might seem odd that one kind of reform should be easier to carry out than the other. After all, they should be mutually reinforcing. All reform creates winners and losers. By muting its distributional impact, fiscal policy can make the medicine more palatable. Once reform has begun to work, it should increase potential growth, stabilising the public finances again.

This is roughly what has happened in countries that have faced a crisis in which everything went wrong at once—such as Sweden in the early 1990s. But in other cases, fiscal measures and broader reforms have not gone hand in hand: indeed, they have often been inversely related. You can have the first without the second, as in eastern European countries after the fall of communism. In western Europe it is more common to have fiscal (and monetary) stabilisation without reforms to improve flexibility, as in Germany and, fitfully, Italy. What you cannot have, it

seems, is both.

Each spring, the Centre for European Reform in London publishes a “scorecard” assessing what EU countries have done to implement the Lisbon agenda of reforms—everything from innovation to liberalising services to labour-market flexibility. Year after year, countries that have done the most to stabilise their public finances do worst on the reform scorecard (this year, they include Poland, Italy and Portugal); whereas countries that do best on the scorecard have done little on the macroeconomic front (admittedly, this may be because their fiscal deficits are under control to begin with).

It is rather as if in Europe there is only a fixed lump of reform to go round. If governments invest time and trouble on improving the public finances, they give up on other reforms. This is damaging. Since countries in the euro can no longer deploy macroeconomic policy to offset the pain of other measures, it drives up the overall cost of reform. As a result, there are fewer reforms than there might be, economies work less efficiently—and it is harder to keep the public finances in order.

But there is more to it even than this. European governments do not just face a difficult choice: they are actively pushed towards favouring macroeconomic stabilisation against structural change to increase flexibility.

Consider the cases of France and Germany. The French prime minister has tried to push through a relatively minor labour-market reform—and his entire position is under threat. Germany's grand coalition, by contrast, is planning what may be the biggest fiscal belt-tightening in decades—and it has just won a round of state elections. Europeans' response to reform seem to be the mirror image of Americans'. In the United States, there is no big opposition to labour-market change, but politicians who propose to raise taxes have a death wish. In Europe, labour reform appears all but impossible, but there is barely a peep of protest against even quite big tax rises.

Why should one sort of reform be politically harder than the other? Partly, because structural, supply-side reforms affect fundamental conditions of life, such as job contracts or pensions, so any planned change is likely to be resisted. Moreover, piecemeal reform that puts the burden of adjustment on particular groups can seem especially unfair. Last year the French government introduced a new labour contract similar to the one that has caused all the protests, for companies with fewer than 20 employees. Employees of small firms were not seen as a group (nor are they organised or powerful), so the change did not run into much opposition (though it is now). But young people are a group that could claim to be singled out by the new contract for those under 26.

Instability and lack of reform pact

The rules of the game make it especially hard for euro members to use macroeconomic policy to support other reforms. Fiscal policy is supposedly constrained by the stability pact, which sets a ceiling on budget deficits of 3% of GDP. Members of the euro have no independent monetary policy: interest rates are set by the European Central Bank. Even if there were a case for easing rates to facilitate reform in one country (say, France), that would be outweighed by the needs of others in the block. Economists also know that the key determinant of success in a single-currency area is economic flexibility. But countries that want to join the euro have to meet targets for macroeconomic stability, not improve their flexibility.

Such problems, argues Jean Pisani-Ferry of Bruegel, a think-tank in Brussels, are rooted in the design of policymaking in Europe. Each policy instrument has been assigned a specific responsibility. Price stability is the preserve of monetary policy; orderly public finances are for

budget policy; structural reforms are desirable to boost growth. It is all neat and tidy. It also makes clear who is responsible for what—vital in a Europe where national governments, the European Central Bank and the European Commission could easily collide. But it can also sever the links between policy areas, and make it harder for countries to pursue all necessary reforms at once.

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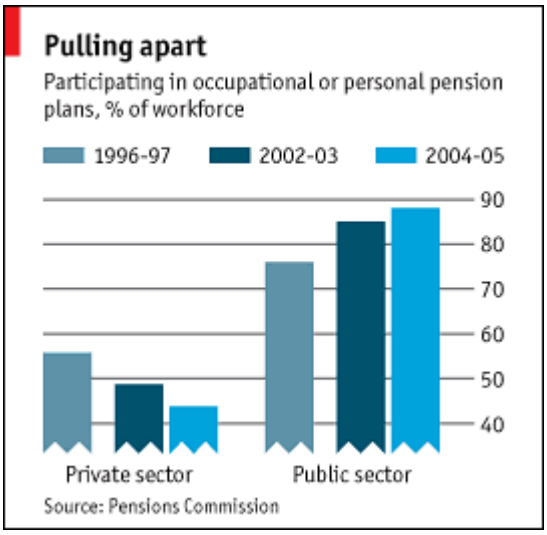
Pension reform

Tug of war

Apr 6th 2006
From The Economist print edition

Despite his peace overtures to Tony Blair, Gordon Brown hasn't let go yet



NOT for nothing are pensions often called the third rail of politics: touch them at your peril. In America, George Bush lost authority last year as his proposed reforms to Social Security went nowhere. Now, in Britain, a plan to rebuild a crumbling pension system has been causing trouble at the very top of government.

Pensions have become the latest high-voltage dispute in the long-running struggle between Tony Blair and Gordon Brown. The prime minister and the chancellor of the exchequer have been feuding over a reform plan laid out in November by the Pensions Commission, a government-appointed body.

Chaired by Lord Turner, a former director-general of the Confederation of British Industry, the commission had already established in 2004 that the existing pension system would be unable to deal with an ageing population. Britain has historically relied upon a partnership between employers and the state. Voluntary occupational and personal pension plans buttress meagre state pensions, which are topped up for more and more pensioners with means-tested benefits.

That partnership has been crumbling, however, as companies cut back their pension plans. New figures presented by Lord Turner on April 4th show that corporate retrenchment continues apace (see chart above), while public-sector workers inhabit an increasingly privileged pension world. Yet the need for adequate pensions for employees, wherever they work, has never been greater as the post-war generation of baby-boomers heads for retirement.

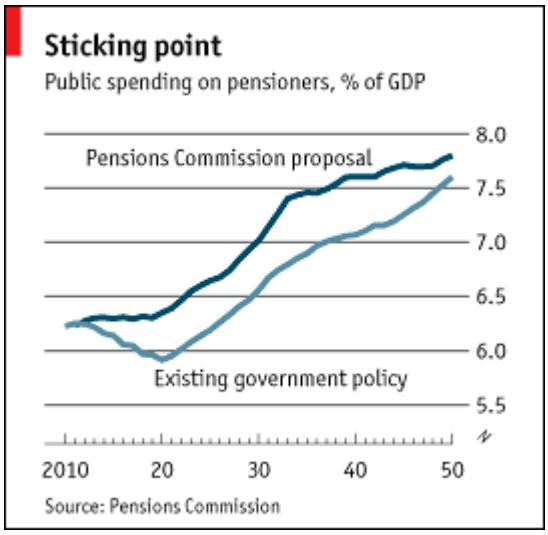
In November 2005 the commission moved from diagnosis to remedies. It made four main recommendations. First, the state-pension age—already due to rise for women from 60 to 65, the present age for men, between 2010 and 2020—should increase to 68 by 2050 in line with increasing longevity. Second, there should be a new low-cost national savings scheme, in which workers would be automatically enrolled, but with a right to opt out. Third, employers would be obliged to contribute to this scheme if workers decided to stay in it. And fourth, taxpayers' money would have to buttress the basic state pension (BSP), the main—and not means-tested—benefit for pensioners.

The commission's proposals won a warm welcome in most quarters, including 10 Downing Street (see article). Crucially, however, that consensus did not include the Treasury. Mr Brown made

clear that he disagreed with the fourth proposal. Since 1980, the BSP has generally been uprated each year with prices rather than earnings. Lord Turner called for the earnings link to be restored from 2010. Since earnings rise faster than prices, this will gradually raise public spending on pensions compared with current policy.

On April 4th Mr Brown appeared to soften his opposition to Lord Turner's plans, saying that he and Mr Blair were “90-95% of the way there with Turner”. That was interpreted by some as a cave-in by the chancellor. Yet Mr Brown insisted again that the cost to the exchequer remained a stumbling-block, saying that he wanted “to avoid a tax consequence” from Lord Turner's recommendations.

If that remains the case, the commission's proposals will not be fully implemented. Under current government policy, state spending on pensioners will fall from 6.2% of GDP in 2010 to 5.9% by 2020 (see second chart), as women's pensionable age rises to that of men. Under Lord Turner's proposal, however, spending rises from 6.2% of GDP to 6.3% over the same period.



The cost of the commission's plan can thus be represented as large or small. Compared with existing policy—the perspective adopted by Mr Brown—the proposal would cost an extra 0.4% of GDP in 2020. That's equivalent to £5 billion ($8.7 billion) in today's money, or nearly 2p on the basic rate of income tax. Compared with projected spending on pensioners in 2010, on the other hand, the additional cost would be just 0.1% of GDP: £1.5 billion in today's money or 0.5p on the basic rate of income tax.

Lord Turner insists that restoring the earnings link, despite its cost, is vital in order to arrest the spread of means-testing which discourages saving. Already, 40% of pensioners are eligible for the means-tested pension credit that Mr Brown introduced in 2003. Without a change in policy, the commission expects this to increase to around 75% of pensioners by 2050.

The central message from the commission this week was that its prescriptions ought to be treated as “an integrated package”. Presenting a final follow-up report, Lord Turner spelled out why the earnings link should be restored: “If the state pension system is not reformed in a way which limits the spread of means testing, the success of the proposed new system of private pension saving will be undermined.” In particular, it would no longer be clear to middling earners that they would be better off staying in the new savings scheme. This would add to costs by making financial advice necessary.

The government is due to make its formal response to the commission's proposals in two months. Mr Blair and the chancellor may have agreed a truce, but it is premature to conclude that Mr Brown has really come into line. The chancellor knows that money will be extraordinarily tight around 2010. The Turner reforms are not in the bag yet.

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Bird flu

The dying swan

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From The Economist print edition

Bird flu hit Britain this week, but the panic is overdone

IF IT had to happen, the timing could not have been better. No sooner had Britain started a test of its defences against bird flu than a swan found dead a week earlier in Fife, near Edinburgh, tested positive for H5N1, the most virulent strain of the disease.

The arrival of bird flu in Britain had long been expected, after its rapid progress westward from Asia, through Turkey and into Western Europe. Seven countries across Europe have now confirmed the presence of the H5N1 virus in wild birds, which has been endemic in China and other Asian countries for a decade. David Nabarro, the United Nations' bird-flu co-ordinator, said this week that he was concerned about the speed with which the disease had spread, infecting birds in 30 new countries in just three months.

Because the British swan was a wild bird, there are no plans for mass culls of the sort seen in Turkey, where millions of birds were slaughtered within days of discovering the disease. Instead, the Scottish Executive has announced a two-mile (three-kilometre) protection zone in which bird keepers are required to isolate their flocks from the wild population. Sales of eggs and poultry from the zone are banned, and monitoring is being stepped up in a six-mile zone around the site.

The British government's chief scientific advisor, Sir David King, told farmers at their national conference in February that he hoped the disease would not spread into domestic poultry if it appeared in wild flocks. But the news from abroad is worrying: this week Germany, which also found its first case in a wild bird, confirmed that the disease had spread to domestic fowl.

As with foot-and-mouth disease, which affects cattle, pigs and sheep, Britain has decided not to vaccinate its poultry against bird flu. Ministers here, unlike those in France and Holland, believe that vaccination can mask infections within flocks, thereby making eradication almost impossible. They reckon a policy of careful monitoring, isolation and culling will prove more effective in the long run.

So far, around 100 people are known to have died from bird flu, most of them in Asia. Most had picked it up through direct contact with birds. But scientists worry that the disease could mutate into a form that is easily transmitted between people, sparking a global pandemic. A government document leaked earlier this year revealed that the Department of Health had ordered 200,000 body bags. That is the worst-case scenario.

Ministers were quick to point out that, for now at least, the disease poses little risk to humans who do not handle birds regularly. A more immediate worry is the likely effect on Britain's farmers. When H5N1 was discovered on a turkey farm in France, Europe's biggest poultry market, sales fell by 30%. Britain's many free-range poultry farmers, who would have to bring their birds indoors, are particularly anxious.

Political-party finances

Thrown together, blown apart

Apr 6th 2006
From The Economist print edition

The parties know there's a problem, but can they agree on the solution?

IT IS not often that the prime minister and the leader of the opposition come together for a private chat. Other than when the country is on the brink of war, it usually means that they need each other for cover. And so it was on April 4th, when Tony Blair and David Cameron met to discuss the tricky issue of how to clean up party funding.

Although Mr Cameron, who requested the meeting, is less implicated personally than Mr Blair because he has only recently become leader of his party, both men have been embarrassed by revelations about the seedy way their parties raised money to fight the general election last May. The favoured approach was to tap rich supporters for loans that, thanks to a loophole in the law, did not have to be declared or the identity of the lenders revealed. That breached the principle of transparency.

But there are also suspicions that some of the loans—£14m ($24m) was raised by Labour and £21m by the Tories, of which £5m has recently been paid back to creditors who preferred to remain nameless—were made on non-commercial terms: unsecured, at low rates of interest, and in the expectation that they might be converted into gifts. If so, they should have been disclosed. Worse still, some lenders may have been allowed to believe that they would get peerages or extract a business advantage in exchange for their largesse.

More is to come. Scotland Yard is investigating whether the 1925 law prohibiting the sale of honours has been broken, while the Electoral Commission is demanding more information about the status of the loans. But both big parties are keen to move on. They think the best way to do so is to put in place new funding rules, including caps on donations, that will deal with sleaze once and for all.

More controversially, both would like to extend state funding for political parties to compensate them for relinquishing big donations. The Tories have suggested that the cash should be linked to the votes secured in the previous general election and each party's number of paid-up members.

That parties badly need to find some alternative to the current mess is not in doubt. Their membership has fallen by 85% in half a century, so subscription income is puny. As ideological and class differences between parties have eroded, fewer people see the point of political activism. Donations from listed companies to the Tories have all but dried up as boards have become warier of using shareholders' cash for political purposes. And unions, although still providing more than half of Labour's money, have lost a third of their members since the 1980s.

But depending so heavily on wealthy benefactors has made the parties vulnerable to charges of sleaze. It has repelled ordinary party members and stoked the cynicism of the wider electorate.

Fixing the problem depends partly on a limit on the size of donations which is strict enough for ordinary voters to believe influence cannot be bought, but also on more transparency and caps on spending, especially during general elections when money is frittered away on idiotic poster campaigns. Establishing an independent honours commission and an elected House of Lords is on the agenda, too.

What is less certain is whether the parties will be able to reach the kind of agreement that would let them make the case for more generous state funding. The brief meeting between Mr Blair and Mr Cameron showed how much scope for disagreement there is.

The Tories are happy to restrict the size of any donation—by individuals, companies or unions—to £50,000 a year because they have many more supporters than Labour who can part with that sort of money. Labour, for its part, is determined to hang on to the cash it gets from the unions. Both parties are intent on gaining some advantage over the other when what the voters want (according to a poll by the Electoral Commission) and might be persuaded to pay for, is a level playing field. It seems a pity.

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Northern Ireland

Taken out

Apr 6th 2006 | BELFAST
From The Economist print edition

More than an ex-spy may have died this week

PA

Brothers in arms

THE timing could not have been more provocative. Just two days before the British and Irish prime ministers were due to announce a plan to revive self-government in Northern Ireland, Denis Donaldson, a former top IRA man turned British agent, was found shot dead in his wretched last refuge in north-western Ireland. Although the IRA denied responsibility, the murder recalled the worst of the violence that the group had supposedly abandoned since laying down their arms last year.

It is not the first time that Mr Donaldson's fortunes have been intertwined with those of devolved government. The head of Sinn Fein's Stormont administration after power-sharing between unionists and republicans began in 1999, he was a familiar figure around the Assembly. Persuasive, on-message, a friend of Gerry Adams, the party's leader, and of Martin McGuinness, its chief negotiator, he seemed to embody the new, moderate republicanism.

But it was the discovery of an IRA spy-ring at Stormont supposedly controlled by Mr Donaldson that brought devolution screeching to a halt in October 2002. When he vouchsafed, in December 2005, that the spy-ring was a hoax and he had in fact been working for Britain's security services since the 1980s, people marvelled that he walked away alive. Proof, it was said, of the IRA's new commitment to peace and politics; Freddie Scappaticci, another IRA turncoat, had also been permitted to vanish discreetly. Mr Donaldson, alas, disappeared only to be hunted down later and murdered.

Mr Adams argues that Mr Donaldson's killers clearly wanted to derail the peace process. That may be correct. Many observers blame dissident republicans, who have often tried to disrupt Sinn Fein's progression towards peaceful political engagement. Some, of course, cry British dirty tricks and blame the ‘securocrats’ who do not like the way the war has ended. But unionists insist that the IRA was behind the killing, pointing out it has lied before.

Whoever murdered Mr Donaldson dramatically upstaged the meeting in Armagh on April 6th between Tony Blair and Bertie Ahern, and thus probably slowed down the return of self-government. The two prime ministers went ahead with their plans, duly proposing a timetable to restore the Stormont Assembly, beginning with a meeting in May. In the preceding days, a series of carefully-balanced gestures had been intended to create goodwill all round: the British army took down the last of its watchtowers along the South Armagh border, and ministers announced £30m ($52m) in grants for depressed loyalist districts.

The biggest stumbling block remains the Rev Ian Paisley, the intransigent head of the Democratic Unionist Party. Mr Blair and Mr Ahern were hoping that a long stretch free of significant violence by the IRA would by the autumn have helped cajole him into sharing power with Sinn Fein. Chances now look more remote. Mr Paisley celebrated his 80th birthday—and a lifetime of blocking compromise—as they unveiled their plans. Mr Donaldson's murder could be seen as a gruesome birthday present, senders unknown.

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Organised crime

Cops and bureaucrats

Apr 6th 2006
From The Economist print edition

British coppers look across the Atlantic for ideas on tackling gangsters

AFP

Bad deeds, good living

BRITAIN has several discrete national police units but no collective acronym for officers to shout when kicking in doors. That changed this week, when the Serious Organised Crime Agency (SOCA) was launched by Tony Blair. It was instantly dubbed the “British FBI”, though its functions are rather different. SOCA will focus on drugs and illegal immigration, but, unlike America's FBI, it has no responsibility for counter-terrorism. The thinking behind creating a national crime-busting agency is, however, the same.

It makes organisational sense to have agencies that are meant to co-operate with each other under the same roof. This also ought to reduce the chances that they will blame each other when something goes wrong, as the National Crime Squad, an elite unit of police officers, and the National Criminal Intelligence Service sometimes did. SOCA brings those two together with investigators from HM Revenue and Customs and the Home Office. The new body has a staff of 4,200, its own snarling logo and a headquarters near Parliament.

But the creation of SOCA is in part an admission of failure. Although the police have managed to reduce other sorts of serious crime (armed robbery and gun crime, for example), Britain is so well supplied with class-A drugs that prices are dropping steadily. According to the Independent Drug Monitoring Unit, the price of a gram of cocaine has fallen by £10 over the past decade to £47, while the cost of heroin has more than halved. The police do have the odd success: this week they arrested five people when 1.7 tonnes of cocaine destined for Britain were discovered in sardine tins. But such hauls must become more regular if SOCA is to disrupt the supply chain enough to raise prices.

To help achieve that, prosecutors also got some new powers this week. The Serious Organised

Crime and Police Act, which came into force on April 1st, provides them with two new tools—financial reporting orders and disclosure notices—to put more pressure on suspects to reveal information. The act also formalises plea bargaining. “Before, once immunity was offered—even if the defendant didn't provide what they promised—they would still have immunity,” says Alison Saunders, head of the organised-crime division at the Crown Prosecution Service (CPS). “Now, if they sign the contract and get a reduction in sentence, but don't provide the information, we can and will take them back to court and remove the benefit.”

Here, too, inspiration comes from America, where the co-operation of gangsters-turned-witnesses has been the key to convicting mobsters. In 2003, according to the CPS, only 1% of defendants in cases brought by British customs gave evidence in exchange for more lenient sentences, compared with 26% in America.

Yet the comparison with America may not hold. Prosecutors there had to prove little to secure lengthy convictions under the anti-racketeering act known as RICO. And “practically everyone indicted with RICO faced life imprisonment,” according to James Jacobs of New York University. That made plea bargaining attractive. In Britain, maximum sentences are much shorter and reductions for plea bargaining are usually smaller, so the incentive to cut a deal is reduced. American prosecutors also made use of wiretap evidence, which is inadmissible in British courts. Changing that rule would probably do more to disrupt criminal networks than reorganising any quantity of agencies.

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Football

A bottomless pitch

Apr 6th 2006
From The Economist print edition

Football clubs try to be more business-minded, sort of

ENGLISH football often generates as much interest for its boardroom manoeuvres as it does for its play on the field. So it was with the news last week that Liverpool Football Club, the current European champion, is in talks that may lead to an investment by a group led by Juan Villalonga, the former chairman of Telefónica, a Spanish communications company.

Mr Villalonga would not be the first foreigner to try his hand at owning an English football club. Last year Malcolm Glazer, an American, paid £790m to take over Manchester United. Roman Abramovich, a Russian billionaire, has ploughed more than £400m into Chelsea since he bought it in 2003.

Yet behind the very public changes in the ownership of English football are signs of a much more unexpected shift: many of the top clubs are trying rather hard to live within their means. Aggregate pre-tax losses by Premier League clubs narrowed to £128m in 2004 after widening for the previous four years, according to the most recent figures compiled by Deloitte, an accountancy firm. Leaving out Chelsea (which is still living it up on Mr Abramovich), Premier League clubs may break even within a year or two, says Dan Jones, the head of Deloitte's sports business.

There are three main reasons for the shift towards profitability. The first is that revenue growth is slowing from 19% a year since 1992 to about 6%, its slowest pace since the Premier League was formed. That has forced managers to budget more conservatively. Players have also trimmed their demands, slowing pay inflation to about 7% in 2004 from 23% a year over the preceding decade. Almost all the increase in 2004 went to Chelsea players.

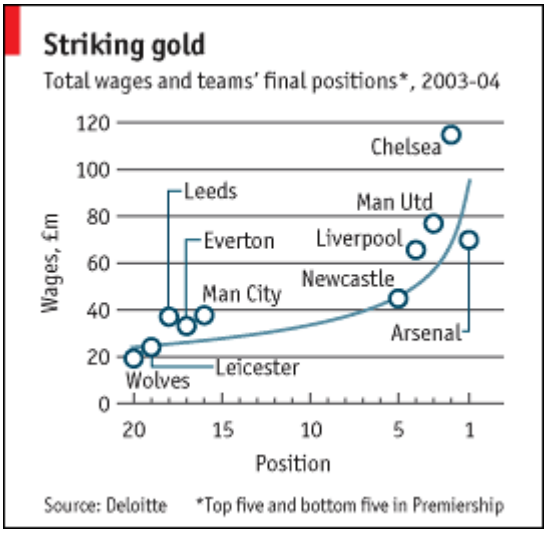
A second reason is the salutary example of the consequences of imprudence presented by Leeds United. The team borrowed heavily, betting that success on the field would increase its revenue and pay its debts. Two bad seasons were enough to fell a club that was among Europe's best.

And lastly, as clubs and their losses grow, the pool of potential benefactors with pockets deep enough to bail them out is shrinking. While a decade ago the average millionaire could adopt a club and pay for its losses, now it takes a billionaire such as Mr Abramovich to do so. With less silly money in the mix, takeovers are increasingly going to be debt-financed deals like that of Mr Glazer—who reportedly knows so little about sport that he cheered for the other team while watching the Tampa Bay Buccaneers, an American football team he has owned since 1995.

Yet even Mr Glazer, who borrowed £275m to buy Manchester United, may struggle to repeat his investment success with the Buccaneers. American sporting leagues are cartels that prohibit new entrants, share revenue, let the worst teams pick some of the best

new talent and guarantee even losers a place in the next year's competition. So owners there can save on wages and maximise profits.

Britain, meanwhile, has an open structure that allows rising teams to fight their way into the Premier League and force losing teams out. Revenue rises in huge steps within the league, with the greatest riches going to the teams at the top.



Because there is a clear correlation between pay and performance (see chart), managers have to spend all they can on hiring top talent in a global market to avoid being relegated from the Premier League. Being knocked out of the league cuts the average club's income by more than a third, says Stefan Szymanski, an economics professor at Imperial College, London. Soccer's bosses know it only too well. “We've got one issue in our industry and that is cost,” says Peter Kenyon, Chelsea's chief executive. “Cost is players.”

So the current penchant for profitability may, in fact, be little more than a passing phase. “There has never been a golden age when clubs made money,” says Mr Szymanski. “It's implausible to believe we're seeing one now.”

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Travellers' troubles

The siege of Dale Farm

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Gypsies at Britain's largest encampment may soon be evicted

MARY-ANN MCCARTHY, the grand matriarch of the Dale Farm traveller encampment, worries that soon she will be on the road again. “I've travelled all my life, thinking of the bailiffs all the while, been moved on more times than I can remember,” she says.

Dale Farm, the biggest encampment of gypsies in Britain, with about 1,000 people, is under threat. Although they have bought the plots on which their caravans sit, only about 400 of the current residents received belated permission to settle on them. The other 600, who trickled in later, did not, and are now in breach of the Town and Country Planning Act.

The occupied pitches are spotless, with a smell of bleach lingering in the air. Containers of flowers sit by the caravan doors. A large gate made out of scaffolding poles bars entry to the site, however, and some pitches have barbed wire around their perimeters. Grattan Puxon, a member of the Gypsy Council, says the residents feel besieged and it is easy to see why.

But so do some of their non-travelling neighbours. Basildon District Council, which is responsible for the Dale Farm site, voted last year to evict its illegal residents, at a cost of £1.9m. Malcolm Buckley, who leads the Conservative council, says that Basildon provides more pitches than most local authorities do, but the district is now full. Yet Richie Sheridan, a spokesman for those at Dale Farm, says that many very old, very young and very sick people live at the site and have nowhere else to go.

The travellers are now awaiting judicial review of the council's decision to evict them, which could come as early as May. The Commission for Racial Equality is intervening in the proceedings to make sure the court takes into account the council's legal obligation to promote good race relations. A much publicised ruling by the House of Lords in March that another group of travellers was not entitled, under human rights law, to remain on land they had occupied illegally is reckoned too different in its particulars to affect the outcome of this review.

These cases are only two of many. In 1994 the government abolished the statutory requirement that local authorities provide sites for gypsies, and the number of sites duly fell. The Office of the Deputy Prime Minister (ODPM) estimates that only 74% of the 16,000 traveller caravans in Britain are on authorised sites. Some 13% of the rest are on sites like Dale Farm, where the travellers own the land but do not have planning permission to live on it, and the remaining 13% camp illegally on other people's property. The ODPM reckons that another 4,000 pitches are needed.

Last month, the ODPM told local authorities that they should provide sites, even though they were not strictly required in law to do so. Dale Farm residents, together with others representing travellers (of Irish origin) and gypsies (of English Roma descent), met civil servants from the ODPM on April 6th to discuss the matter, two days before they celebrate International Roma Day.

But there is little enough to cheer about in most travellers' current plight. They often have health problems. A recent census in Leeds found that their life expectancy was 50 years, compared with 78.2 years for the rest of Leeds.

There is another wide gap in education. In 2003, just 23% of Roma gypsy children and 42% of Irish travellers obtained five or more good GCSEs, compared with an average of 51% for all children. Theirs were the worst results for any ethnic group. Many parents cannot read and write, and an increasing number are willing to settle down so that their children can get the education they lack themselves. But local schools are not always keen.

One primary school near Dale Farm, Crays Hill, has 45 traveller children enrolled, although their attendance is erratic. Almost all the non-traveller children have been withdrawn, reducing enrolment by around three-quarters. Basildon District Council has pledged to keep the school open, although Mr Buckley, its leader, questions this decision: “If only a few children turn up each day, shouldn't our resources be spent elsewhere?”

Local people are divided over whether the travellers should be kicked out. Some complain about falling house prices and legal breaches. Others are less bothered.

Mr Buckley has called in bailiffs that specialise in removing travellers. One such firm is Constant and Company. “I've got nothing against travellers, they are our stock in trade, but what is the contribution made by travellers to this country?” says Bryan LeCoche, who works for Constant. “They don't pay income tax, they want everything for themselves without giving anything back.”

Yet Nigel Smith, the leader of the Basildon Labour group, speaks for many who oppose forcible eviction: “To deal with a human rights issue under planning law is crazy,” he says. And the local priest, Father John Glynn, goes much further: “I'll be up there at the site if they evict the travellers. And my poster will say ‘This is ethnic cleansing.’” Time will tell how many rally to that banner.

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Bagehot

Caught in the middle

Apr 6th 2006
From The Economist print edition

Being a minister is hard enough without having to serve two masters

NOBODY will be more relieved than John Hutton if the chancellor's apparent change of heart in favour of the recommendations made by Lord Turner in the final report of the Pensions Commission proves to be sincere (see article). That would bring Gordon Brown's views into closer alignment with those of the prime minister, thus saving both Mr Hutton's sanity and, quite possibly, his career.

Mr Hutton is the secretary for work and pensions, and his predicament is an extreme version of one faced by almost every other ambitious government minister. They find themselves trapped between doing the things Tony Blair requires of them in order to establish his legacy and provoking the anger of Gordon Brown if they set policy too firmly on a course he disapproves of.

Mr Hutton is a fervent Blairite who shares the prime minister's insatiable enthusiasm for “reform”. Perhaps more than anyone, Mr Hutton, who served at the Department of Health for seven years under three secretaries of state, has been responsible for implementing Mr Blair's vision for the NHS.

When the prime minister asked Mr Hutton to go to the Department for Work and Pensions last year, there was no doubting his intent. From 1997 until 2004, the department had operated as a Treasury fief, run by a succession of ministers whose primary political loyalty was to Gordon Brown. Mr Blair had come to believe that two objectives he had set himself before leaving Downing Street—toughening incapacity-benefit rules and achieving a lasting settlement for pensions—could not be realised while this continued.

First Alan Johnson and then David Blunkett were sent to the department to do the prime minister's bidding. Mr Johnson was reshuffled after the election and his replacement, Mr Blunkett, turned out to be less robust in his dealings with Mr Brown than Mr Blair had hoped. The prime minister saw in Mr Hutton a tough-minded technocrat who would get on top of the detail and stand up to the inevitable bullying from the Treasury.

Although he is an ardent New Labour moderniser, Mr Hutton would immediately have realised the danger of his new position. He had, after all, seen at first hand the fate of Alan Milburn, his boss at the Department of Health and a former flatmate. Mr Milburn's clash with Mr Brown over the degree of financial freedom to be conferred on foundation hospitals, coupled with Mr Blair's failure to stand up to the chancellor, led to his decision to quit the cabinet, a frustrated and disillusioned man. Then, when Mr Blair persuaded him to return to run the general-election campaign, it ended in tears. Mr Milburn learned for a second time that the prime minister's support is inadequate protection against the chancellor's enmity.

Mr Hutton is a cannier, less flamboyant operator than Mr Milburn. His handling so far of the tricky welfare-reform issue has been assured, provoking neither indignation among Labour backbenchers nor yet the hostility of a Treasury reluctant to pay for expensive programmes to propel benefit claimants into work. Mr Hutton should be able to keep Mr Brown on-side if his demands on the exchequer are modest.

Pensions, however, are fraught with greater risk. Mr Blair is determined to sort out the issue before he leaves office and wants a bill announced in the Queen's Speech in October. Mr Brown, on the other hand, sees no need for haste, as the changes proposed by Lord Turner would not come into effect until 2010 at the earliest. He would rather the matter were left to him to deal with when he becomes prime minister. Mr Brown also feels strongly that, as he is likely to be the one who has to persuade the electorate about the unpalatable prospect of later retirement and higher taxes, it should be on his terms and not Mr Blair's.

A further awkwardness for Mr Hutton is that Mr Blair is known to share Lord Turner's dim view of the pensions regime designed by Mr Brown. Although the chancellor's pension credits have done a good job in improving the lot of poor pensioners, both Mr Blair and Lord Turner regard the policy as unsustainable because it discourages saving. What is especially galling for Mr Brown, the arch long-game strategist, is that he is accused of short-termism and of discouraging thrift and self-sufficiency, virtues that Brownism usually extols.

What's a minister to do?

If Mr Brown has indeed decided that the risks of opposing the Turner consensus outweigh his feelings of indignation, Mr Hutton may escape Mr Milburn's fate for now. But whether or not Mr Hutton succeeds in producing a white paper this summer that the chancellor can live with, the tension caused by trying to serve two masters is both personally wearing and unlikely to produce the best policy.

Other ministers face similar dilemmas. The health secretary, Patricia Hewitt, believes that the next 12 months will be exceptionally difficult as well as critical for embedding the health reforms. Mr Blair wants her to keep her foot on the accelerator. But what does Mr Brown, who used to be sceptical about the role of quasi-markets in health and who will have to account to the voters for the state of the NHS, want her to do?

David Miliband, a fast-rising young cabinet minister who is tipped to become Labour's leader after Mr Brown, is working on a white paper that will radically overhaul the relationship between local and central government. Its impact will not be felt until well after the date when Mr Brown is likely

to have become prime minister. Mr Brown and Mr Blair may be in rare harmony over local-government finance, but it is unlikely. In which case, who should Mr Miliband aim to please?

This is a thoroughly unhealthy state of affairs that will be brought to an end only when Mr Blair departs. Yet despite everything, few senior ministers are looking forward to that day.

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Chasing the rainbow

Apr 6th 2006
From The Economist print edition

Getty Images

Since the end of apartheid, South Africa has moved closer to becoming the "rainbow nation" of Nelson Mandela's vision. But not nearly close enough yet, says Richard Cockett (interviewed here)

Get article background

IN THE 12 years since the African National Congress (ANC) party triumphantly took power in South Africa's first multiracial democratic election, there have been plenty of reasons to be disappointed, even disillusioned, with Africa. The "aid darlings" of the West have come and gone. Yoweri Museveni of Uganda changed his constitution to win a third presidential term in dubious circumstances, and Meles Zenawi, Ethiopia's prime minister, ruined his reputation when his police shot dead scores of opposition supporters last year. Robert Mugabe, the last of the original "big men" of Africa, seems bent on impoverishing what was once one of the continent's most prosperous countries, and the government of Sudan continues with its genocidal military campaigns against its own people. Nor has the continent yet conquered famine: in the Horn of Africa, parts of Kenya, Somalia and Ethiopia are currently facing critical food shortages.

But through all this, South Africa has plotted its own course to relative stability, democracy and prosperity. It has even been trying to nudge the rest of Africa towards emulating its own success. In that sense, South Africa is beginning to lead the continent in an entirely new way.

When the apartheid regime fell apart in 1990, South Africa, remarkably, did not erupt in flames. That it did not was due largely to the leadership of Nelson Mandela. No less remarkable since then has been the ANC's relentless campaign to alleviate the poverty and degradation of the victims of apartheid without resorting to counterproductive populism. Despite inheriting an economic mess from the outgoing National Party in 1994, the post-apartheid government has managed to build

1.9m new homes, connect 4.5m households to electricity and provide 11m homes with running water. Its targets for raising the living standards of its people are the most ambitious on the continent.

Yet a drive from Cape Town airport into the city's almost exclusively white suburbs at the foot of Table Mountain demonstrates that South Africa is still deeply scarred by the legacy of apartheid. Here the cars rush through miles of shanty towns and townships on the Cape Flats, the geography of apartheid very much intact. It is a similar story throughout South Africa. Yes, the shacks in Cape Town now have electricity. But what else has really changed? Yes, the giant township of Soweto, flashpoint of apartheid, now also has electricity and smart paved roads. But has its upgrading not further entrenched the separation of 3m blacks from the city of Johannesburg, from which many were forcibly removed 50 years ago?

Why are we waiting?

There is now a sense of impatience over the pace of change in South Africa. For many, the country's advance towards Mr Mandela's vision of a “rainbow nation” has slowed to a crawl. The government is well aware of this, and is now intervening in more and more areas of national life to try to speed up change.

Yet those interventions could do more harm than good. As this survey will argue, South Africa has some good stories to tell about change, but few of them are entirely the ANC's doing. From education to foreign policy to crime-fighting, the South African people have found creative solutions to many of their problems. That creativity is South Africa's most impressive asset, and increasingly comes from the poorest and historically most disadvantaged of South Africa's communities, who are now building their own ladders out of poverty.

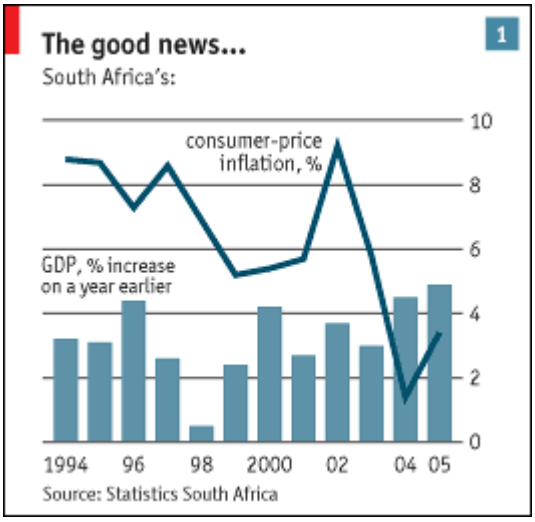
The frustrating economy

By rights, the government should be basking in the glow of an outstandingly successful economic performance over the past decade. Having inherited a pile of trouble from the disintegrating apartheid government, the government has since presided over an impressive 87 straight months of growth (currently running at about 5% a year), low budget deficits and low inflation.

The Johannesburg Stock Exchange, riding the wave of the commodities boom, has been making record gains. Consumer demand has been buoyant, with the signs of conspicuous consumption all around, from the gaudy new gated housing estates to the increasing numbers of sleek European sports cars on the roads. House prices rose by 21% in 2005 (a welcome slowdown from 32% in 2004), and new-car sales in January this year were 22% up on a year earlier. For 2006 as a whole, the National Association of Automobile Manufacturers of South Africa expects them to be even higher than last year's 617,500.

Buoyant domestic demand has recently been accompanied by the sort of foreign investment that some thought would never come. Barclays, a big British bank that withdrew from South Africa in 1986 under pressure from anti-apartheid campaigners, has just bought its way back into South Africa with the $4.5 billion purchase of a majority stakeholding in Absabank, the country's biggest retail lender. That is the largest foreign direct investment ever made in South Africa. And Britain's Vodafone has

recently made a substantial investment in Vodacom, a South African mobile operator.



Yet for all the good economic news, the government is looking politically more vulnerable than at any time since 1994, for a simple reason: little of this growth has benefited its own core supporters, who are overwhelmingly poor and black (a term used in this survey to describe people of black African descent only, whereas the ANC applies it to all people of African, Indian and mixed-race origin). The problem is summed up by the unemployment rate, which even on the narrowest official definition stands at about 27%, a slight increase on a year earlier, despite the 5% GDP growth (see charts 1 and 2). The economy is generating jobs, but not enough to keep pace with the number of new entrants into the labour market.

The government's other big problem is rising inequality. There is a lot of talk about a growing black middle class, but the number of people living on the poverty line may actually be rising. Thabo Mbeki, the country's president, has spoken of the gaping divide between South Africa's "first economy" and "second economy", echoing Benjamin Disraeli's analysis of early industrial Manchester.

The ANC has always pledged itself to work for the poor and the disadvantaged, so its grassroots supporters are particularly unhappy. Their discontent surfaced in the local elections on March 1st, at which the ANC faced a genuine challenge for the first time in its brief democratic history. It did better than expected, but still saw its vote fall in some areas. Last year, in the absence of any elections, there were about 880 illegal street protests, mostly about the lack of basic services and housing.

In the years after 1994, the ANC had to reassure the international financial community and the money markets that investments in South Africa were safe and that the government was not going to nationalise everything in sight. Thus the new leadership spent most of its time looking over its right shoulder, wondering how to reassure capitalists and whites—which usually amounted to the same thing. Its answer was the GEAR (Growth, Employment and Redistribution) programme, launched in 1995, which committed the government to an orthodox, prudent economic package.

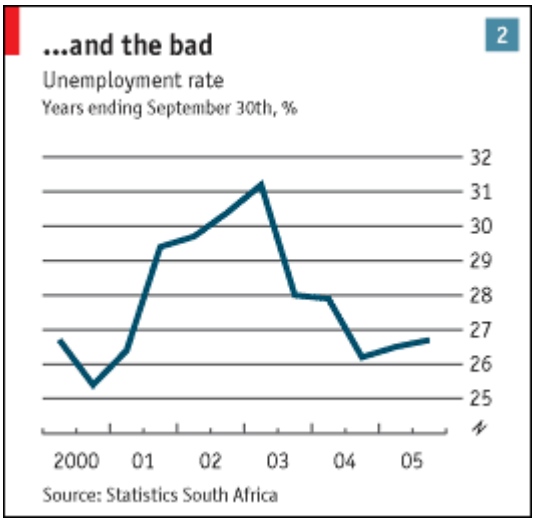
That prudence paid off, bringing economic stability and launching a consumer boom. But as the government has conceded, GEAR did not create enough jobs, nor did it produce the hoped-for investment, domestic or foreign, that might have generated more of them. So now the ANC leadership is looking more over its left shoulder, at the disgruntled activists who feel let down by the government.

Since the early 2000s, the "fiscal stance began to move into a more expansionary phase", as Alan Hirsch, the head of the president's economic policy unit, puts it. That meant, in the first instance, more money for a programme of social grants, mainly for child support and pensions, which go to about 10m people (out of a population of 47m). But now Mr Mbeki is embarking on a more ambitious programme to find the jobs that have so far eluded him: the Accelerated and Shared Growth Initiative for South Africa (ASGISA). According to Joel Netshitenzhe, the government's chief spokesman, this is "very Keynesian, with a bit of Roosevelt's New Deal". It will involve spending 370 billion rand over the next three years on public works, mainly infrastructure, to boost jobs and create more demand that will also be spread more evenly. Some sectors, such as

tourism, will be specially targeted. The longer-term aims are to raise the growth rate to 6% by 2010 and to halve unemployment and poverty by 2014.

Alec Erwin, the minister of public enterprises, argues that the country can well afford this, given its excellent economic record and low budget deficit; there will be no new taxes or borrowing. The government has also promised to continue with its supply-side reforms, such as cutting red tape for small and medium-sized firms.

So will ASGISA deliver the goods? Undoubtedly some jobs will be created, and there is even a neat deadline for getting things done: South Africa is due to host the football World Cup in 2010, and plans to build five new stadiums and renovate another five. But as likely as not, the project will get caught up in the twin bottlenecks that have already caused much trouble in the new South Africa: a severe skills shortage and a failure to deliver services at the local level. In 2002, a bank estimated that 300,000-500,000 vacancies remained unfilled because there were not enough skilled people to recruit. The proposed infrastructure projects will call for large numbers of the engineers, technicians and other skilled professionals that South Africa lacks. Already there are stories of state-owned companies looking abroad to recruit skilled workers that they cannot find at home. There is a plan, the Joint Initiative for Priority Skills Acquisition, to develop the skills base as ASGISA unfolds, but it will probably be too little, too late.



The proposal to spend a lot of the money at the municipal level is fraught with risks too. The provincial governments work quite well now, but the local ones less so. With more money flowing through them, inefficiency and corruption could simply become more entrenched.

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From revolution to evolution

Apr 6th 2006
From The Economist print edition

The ANC is becoming a more ordinary party

EPA

Too much electoral passion

Get article background

THE violence that marred the local elections in March, with burning tyres, tear-gas and improvised barricades, was reminiscent of the apartheid-era images from Soweto. This time, though, the demonstrators' ire was directed not at racial segregation but at the more mundane matter of municipal boundaries. That these protests got so badly out of hand says a lot about the ANC's difficulties in turning itself into a modern, democratic party.

Almost a century old now, the party has for most of its life been a revolutionary liberation movement fighting a quasi-fascist regime in the midst of the cold war. Many of its exiled leaders, including Mr Mbeki, went to school or university in Britain or America, but also trained in the Soviet Union to win their armed struggle.

The ANC still has a top-down, authoritarian structure where loyalty to the political cause is prized above almost everything else, including competence. There is endless debate within the party, but once an internal “consensus” is reached, everyone has their orders. As one diplomat and long-time observer of the party says, “People are deployed to do jobs that they are not fit to do, and the ‘consensus' means a loyalty to people who do not work, or who are not effective...clientism hinders rational distribution of resources.”

Professor Lawrence Schlemmer, an independent consultant, argues that ANC people never learn the nuts and bolts of administration as they move from one job to another: “There are not enough people who worry about paperclips.” This shortcoming is most obvious at the local level, where

incompetence and ineffectiveness are widespread.

There is growing resentment of the way the party imposes its politics from the centre, often by forcing candidates for municipal or provincial elections on its local branches. In last month's local elections, hundreds of local ANC members protested by standing as independent candidates, and much of the rioting was about the government's redrawing of provincial boundaries with little or no consultation.

But the greatest weakness of the ANC's top-down system is that the party is inclined to dismiss ideas from outside its own bureaucracy. The most obvious example has been Mr Mbeki's well-documented response to the HIV/AIDS crisis. For a long time, Mr Mbeki stood out against the combined weight of world medical opinion on the causes and treatment of AIDS, and particularly on the use of anti-retroviral drugs.

The main group campaigning for their use, the Treatment Action Campaign, was made up almost entirely of ANC members, and Mr Mbeki seems to have resisted their arguments as much because he felt they were breaking party ranks as for their prescriptions on AIDS (with which he disagreed). In 2003, the government eventually caved in to domestic and international pressure and gracelessly introduced a comprehensive management regime involving anti-retroviral drugs to combat HIV/AIDS.

Alamy

This may have signalled a change of policy by the government, but not, it seems, much of a change of mind. In a country with 5.2m HIV-positive people on record, the largest number in the world, there is almost no public acknowledgment of the problem or public education about it. Taking their cue from the top, ministers (with a few honourable exceptions) still seem loth to talk about the illness, which kills about 900 people a day and undermines much else that the country is trying to achieve. It handicaps the army, with an infection rate said to be up to 40%, breaks up families and kills much-needed teachers. Chillingly, the Actuarial Society of South Africa estimates that it will be another ten years before the pandemic peaks.

The tardiness with which the government responded to the HIV/AIDS crisis, together with Mr Mbeki's own strange take on the underlying science, has tarnished his own reputation, as well as that of the ANC. Critics argue that the government remains ambivalent about its commitment to fighting the pandemic with anti-retroviral drugs. The government's plan to combat HIV/AIDS may be a model of its kind in intent, but it is already falling behind. By the end of this year about 225,000 patients will be receiving anti-retroviral drugs, well short of the plan's target of 380,000 by 2005-06.

Mr Mbeki's unorthodox views on the causes and cures of HIV/AIDS undoubtedly have something to do with his agenda of finding African solutions (rather than expensive Western ones) to Africa's problems, of which more later. But the AIDS saga, together with the ANC's unresponsiveness to its own supporters and its failure to deliver on its promises, has diminished the aura of moral

authority the party had earned during the long struggle against apartheid.

William Gumede, a political analyst, says that the moral basis of the ANC is in decline, and that it is well on the way to being judged as “just an ordinary party”. He also points to growing signs of petty corruption, such as MPs fiddling their expenses. Indeed, some argue that the local elections on March 1st were a watershed for the party because they were the first elections since 1994 that it actually had to work at winning. It could no longer just crush opposition by the sheer weight of its past success.

However, in one vital sense the ANC is very much not “an ordinary party”: it faces no serious competition. The nearest thing to a formal opposition is the Democratic Alliance, largely an amalgam of old white parties, led by the very combative (and white) Tony Leon. It got 12% of the vote in the 2004 elections, against the ANC's 70%. But only 3% of its voters are black, so in an overwhelmingly black country it has a very long way to go.

It remains true, then, that the real debates about the future of South Africa take place within the governing alliance of the ANC and its partners in the Congress of South African Trade Unions (COSATU) and the once-mighty South African Communist Party (SACP), rather than between the ANC and other political parties. COSATU and the SACP have been unhappy for several years about what they see as the government's unduly neoliberal economic policies. Given the rising levels of discontent amongst the ANC's largely poor and black voters, there has been talk about a new block emerging on its left. But ultimately COSATU and the rest know that short of setting up a whole new political organisation with money they do not have, the ANC is their only option.

Discontent on the left might have come to a head last year with the sacking of Jacob Zuma, Mr Mbeki's deputy, after allegations of corruption. He is everything that Mr Mbeki is not: charismatic, populist and at ease with ordinary ANC supporters. For a moment, it looked as if he might become a rallying point for opposition to the leadership. But the discipline honed over decades quickly reasserted itself.

So, halfway through his second (and, constitutionally, last) term of office, Mr Mbeki, the technocrats' technocrat, is still in tight control. But the ANC's style and structure risk becoming anachronistic in the new South Africa, where society is evolving in a more plural, liberal and democratic direction. Next year the party is due to pick a leader to contest the presidential election due in 2009. It needs someone who can, as one ANC insider puts it, “mobilise” its supporters again. With Mr Zuma now probably out of the running, the field of possible successors is unusually wide open.

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Africa's hegemon

Apr 6th 2006
From The Economist print edition

Thabo Mbeki's many foreign-policy successes, and his one big failure

PA

Mbeki says nothing, Mugabe hears nothing

Get article background

IN FOREIGN policy, Mr Mbeki has managed to develop a vision of post-colonial Africa with an energy and effectiveness that has often eluded him at home. His admirers like to call him a foreign-policy president; his political opponents jibe that he spends more time abroad than he does in South Africa.

The transformation in the country's relationship with the rest of the world since 1990 has been remarkable. South Africa has moved from being an international pariah under apartheid, boycotted and cut off, to become one of the most engaged, open and connected countries in the world. The most obvious and pleasurable sign of this for sports-mad South Africans has been the ceaseless flow of world sporting events that their country has hosted since 1994, including rugby and cricket world cups, with the football equivalent to come in 2010.

A lot of this re-engagement was inevitable, given that South Africa remained, even through the worst of the apartheid years, Africa's leading economy. But Mr Mbeki has added his own distinctive twist to this natural resurgence with a foreign policy based on African solutions to African problems. It is likely to prove his most important legacy.

Adam Habib, a professor of politics at the Human Sciences Research Council in Pretoria, describes Mr Mbeki as the “quintessential African nationalist”. This is his main intellectual and emotional inheritance from the liberation struggle, and has driven his desire to emancipate his own country, and hence Africa as a whole, from racial oppression and colonialism. His principal aim has thus been to establish the new South Africa as, first and foremost, a black African country—rather than, as Peter Kagwanja of the International Crisis Group puts it, “a white, exceptional country”. Mr

Mbeki's other ambition has been to persuade Africa to set up its own institutions and mechanisms for solving its problems, thus ending the constant, humiliating requests for aid to the West's former colonial powers.

Mr Mbeki has led South African interventions all over the continent to prove his country's African-ness and show its commitment to the continent's problems. In Burundi, Mr Mbeki's government followed up on Mr Mandela's earlier work to get all the parties to the negotiating table to end a civil war. In the Democratic Republic of Congo, one of the continent's most war-ravaged states, South Africa has been heavily engaged in the complex negotiations that produced a successful referendum on a new constitution last year. South Africa has also played a part in ending conflicts in Sudan and Liberia. Mr Mbeki was less successful in his personal efforts to mediate in Côte d'Ivoire, but that is probably the continent's most intractable conflict now. South Africa has also sent thousands of troops as peacekeepers and observers to these countries once the fighting was over.

However, Mr Mbeki has been at his most creative in trying to set up permanent institutions to serve Africa. The New Partnership for Africa's Development (Nepad) was very much his own idea, launched in 2001. Headquartered in South Africa, Nepad is designed to make African countries themselves responsible for upholding standards of democracy and good governance through the African Peer Review Mechanism. Mr Mbeki also played an important part in turning the old, useless Organisation of African Unity into the new African Union (AU), under whose auspices South Africa now hosts the new Pan-African Parliament; and he is also involved in the new African Commission on Human and Peoples' Rights.

Africa-pessimists are quick to belittle all this pan-African institution-building, and it is easy to point to the failures. The AU's only military force to be deployed has been so ineffectual in the Darfur region of Sudan that it might yet be replaced by a UN force. So far, only four countries have submitted themselves to the Nepad peer-review procedure, and none of the country reports has been made public.

But there have been successes too. The AU acted quickly in Togo last year to reverse a coup; and in January this year South Africa led successful diplomatic efforts to stop Sudan getting the chairmanship of the AU, in protest against the Sudanese government's policies in Darfur. The African Commission on Human and Peoples' Rights, meanwhile, has issued a report saying that the Zimbabwean government should be investigated for gross human-rights abuses.

But South Africa is not just being altruistic: its involvement in the rest of the continent is closely bound up with its own economic prospects. As Aziz Pahad, the country's deputy foreign minister, argues, “We cannot sustain our economic growth if Africa continues in poverty, so it is in our own self-interest. You can't have development without conflict resolution.”

It is no coincidence that South African investment in other African countries has boomed in the past few years, reflecting the country's deepening political and diplomatic engagement beyond its borders. Companies such as MTN and Vodacom, two mobile-phone operators, Protea, a hotel chain, and Standard and Absa, two banks, have all successfully expanded into other African countries recently. MTN's chief executive, Phuthuma Nhleko, says the South African government “is seen as a constructive force for good on the continent, and that has helped South African business a great deal.”

But for all the work that it does in its continent, South Africa is almost paranoically careful not to throw its economic and diplomatic weight around or to act out of step with its African partners. It is often jokingly tagged as the “America of Africa” by other Africans, and takes the dig seriously. It knows that there is a lot of resentment of its size, its relative success and, still, its whiteness.

Moreover, other countries, such as Nigeria, Kenya, Egypt and Ethiopia, like to think that they have claims to leadership too. South Africa has been cautious about pushing for an African seat (or two) on the UN's Security Council, despite its obvious qualifications. In the eyes of the rest of the world, a South Africa personified by Mr Mandela may have a claim to moral leadership. But within Africa, South Africa was the last former colony to claim its freedom, and knows its place in the continental pecking order.

Inaudible diplomacy

All these sensitivities collide with each other on the subject of Zimbabwe. Here, Mr Mbeki's Africanist credentials trump his Nepad ambitions that African countries should help each other uphold standards of good governance, human rights and democracy, none of which Robert Mugabe, Zimbabwe's president, seems to care much about. For blacks throughout Africa Mr Mugabe remains a revered icon of the liberation struggle, the man who helped to fund the ANC in exile, and South Africa will not break with the general African consensus on this.

Behind the scenes, there is Mr Mbeki's “quiet diplomacy”, a campaign to persuade the opposing sides in Zimbabwe to accept the sort of compromises and reconciliations that worked in South Africa. But so far, Mr Mugabe has shown no signs of listening. Indeed, it looks as if South Africa has already exhausted the means of quiet diplomacy, yet Mr Mbeki proudly refuses to say anything louder. By any standard, Zimbabwe has been Mr Mbeki's biggest foreign-policy failure.

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Righting the wrongs of apartheid

Apr 6th 2006
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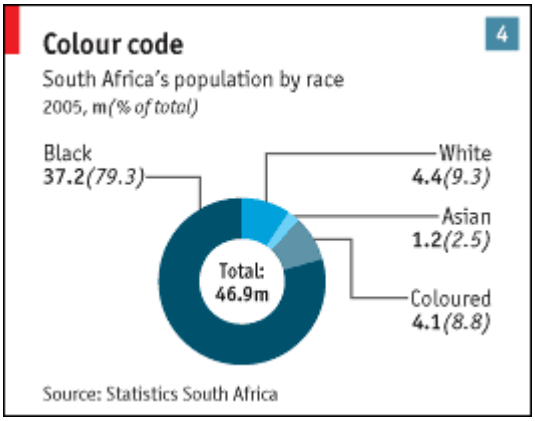
But affirmative action has its limitations

Get article background



AS PART of the historic deal struck in 1994 to ease the way for democracy, South Africa's whites ceded political power to the ANC. In turn, the ANC accepted that (mainly white-run) capitalism would continue. But the new government also vowed to take action to redress the injustices and inequalities that had developed over 40-odd years of apartheid, not to mention centuries of colonial rule.

The Truth and Reconciliation Commission was part of that effort. Trading amnesty for truth, people from both sides of the struggle came forward to give testimony about the brutality of the apartheid regime. The work of that commission is now finished, and attention has shifted to the two other pillars of redress, black economic empowerment (BEE) and land reform. Both cause fear and alarm among foreign investors.

In fact, as originally conceived, both policies are more benign than their detractors make out. Formulated in the spirit of compromise and pragmatism that has characterised the best of the ANC since 1994, they involve hardly any direct government coercion. Supporters such as Leslie Maasdorp, an ANC activist, financier and former adviser to Goldman Sachs, argues that BEE is aimed at nothing more scary than the “normalisation of South Africa” by “de-racialising the capitalist class”.

All the same, there are concerns that the government's quest for historical redress is becoming ever more intrusive. The most onerous innovation has been the Broad-Based Black Economic Empowerment Act of 2004. This imposes a host of obligations on companies that want to do business with government. This goes far beyond the previous rules about “equity ownership”, under which companies had to transfer a proportion of their shares (normally about a quarter) to black ownership. Now, to be BEE-compliant, companies have to meet seven different criteria, which include having a designated share of blacks in upper and middle management, paying for skills development and buying a proportion of their materials or expertise from other BEE companies.

But being a BEE-compliant company has become a legal minefield. A growing army of lawyers, consultants and accountants now specialise in BEE equity deals, adding considerably to the cost of doing business. Reg Rumney, director of the BusinessMap Foundation, a business-research organisation, argues that “in effect, the government has created a whole new industry of racial auditing.”

The big question is whether all this meddling will have the desired effect: to create a black middle

class that reflects the share of blacks in the population as a whole, around 80%. This would be proof that the rewards of the “first economy” are being fairly spread around. But so far it has not happened. The government is justifying its ever more complicated interventions in the economy by the need to hurry the process along. Many in the ANC argue that by leaving things largely to the market, all that has been achieved is the creation of a small elite of rich, politically well-connected black businessmen, whereas the rest have missed out.

That elusive black middle class

The evidence on this is contradictory. Depending on how it is measured, and by whom, estimates of the proportion of blacks in the middle class range from 22% to 40%. Whatever it is, it has probably doubled since 2000. Certainly, impressive growth in the housing and car markets seems to be fuelled by an increasingly affluent black middle class, especially in cities such as Pretoria and Johannesburg.

But Neva Makgetla, a policy adviser for COSATU, points to something that explains a lot of the unease about the growth of the black middle class. Most of that growth has come from rising numbers of blacks in public-sector jobs, where they have been “politically more able to get jobs”. By contrast, the proportion of blacks in senior jobs in the private sector or the professions has moved up only slightly since 1995, to about 25%. The government has concluded that the private sector is not doing its bit, hence the more rigorous affirmative action in the 2004 BEE legislation.

Yet already the BEE project is causing a host of new problems. To meet their “employment equity” targets, companies are now raiding the only place where they can find trained black managers: the public sector. They are paying top money to lure away the best people, thus exacerbating the skills crisis in government. At the same time white skilled workers have been emigrating because positive discrimination in favour of blacks prevents them from getting jobs at home. In a U-turn, the government is now calling some of them back.

Current policies also discourage well-qualified blacks from becoming entrepreneurs. Why take the risk of starting up their own business when they can name their salary to join a company desperate to meet the BEE criteria? The big hole in the South African economy is its relative lack of small and medium-sized enterprises. Currently they create only 30% of new jobs. One business consultant estimates that of the serious new business start-ups in 2003-04, only 10% were black. But a better way to spread black empowerment would be to make life easier for start-ups and small businesses.

Land reform is an even more emotional and sensitive issue than BEE, partly because apartheid was founded on denying blacks access to their own historic lands in 1913, and partly because of Robert Mugabe's confiscatory land policies next door in Zimbabwe. Yet, paradoxically, it is less important. Like BEE, the land-reform programme has been conceived in a thoroughly pragmatic way. But as with BEE, the process has been slow, too slow for many activists. According to Jeffrey McCarthy, a land expert for CDE, a think-tank, “government has the right policies, but they are not being executed with sufficient vigour or refinement.” The government has probably not set aside enough money for its land bank, which helps black would-be farmers to buy land from whites. But then land is not as big an issue in South Africa as it is in Zimbabwe, where farming still dominates the economy. In South Africa agriculture now accounts for only 3% of GDP, and the pressure on land is all in the cities.

Land redistribution can work well, sometimes with the former white owners helping to manage the farm. But as with BEE, there is pressure from within the ANC to speed things up. There were worries when the government said it would re-examine the current mechanism for redistribution, based on agreement between a willing seller and a willing buyer, which raised comparisons with

Zimbabwe. But all the government has to do is to put more money into its existing schemes to meet the limited demand. As Mr McCarthy says, “the government is unequivocally upholding property rights,” and most people expect it to go on doing so.

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Ladders out of poverty

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No education, no future

Panos

Seat of learning

Get article background

ZAMA, Brian, Comfort and Gloria are all 13 or 14 years of age, as young as their country's new democracy, and have ambitions to match those of the new South Africa. They all want to go to university; then Comfort wants to be a doctor, Zama an actress, Gloria a teacher and Brian a lawyer.

Children the world over dream about those sorts of jobs, so there is nothing unusual about that. But if those four and their peers do go on to realise them, they will have achieved something remarkable: it will be the first time that anyone in their families will have risen out of the degradation and poverty imposed by apartheid.

These young blacks come from the bottom of the pile, from Johannesburg's townships and shantytowns. Their fathers, if they are around, are waiters and taxi drivers, but many of the children come from single-parent homes, and that single parent is often unemployed. Zama's mother moved from the North-West Province to Johannesburg last year in search of domestic work, and the only place they could find to live was a squatter camp appropriately called Diepsloot, or “deep hole”. They are lucky to have a one-bedroom government-built house rather than a shack. Zama describes her area as “very dangerous, with lots of criminals. When you are sleeping, you can hear gunshots.”

Nonetheless, these children have good reason to aim high, for they all go to an extraordinary school called Sekolo Sa Borokgo, in the northern suburbs of Johannesburg. In a few bare classrooms grouped around a tiny courtyard, the 25 teachers inspire their almost exclusively black “learners” to remarkable academic progress. Last year the school achieved a 100% pass rate in the “matric” examination usually taken by 18-year-olds, and nearly two-thirds of them went on to university. The headmaster, David Roussouw, proudly recalls his top performer, a girl who lived in a one-bedroom house in Soweto with her mother, who has gone on to the University of Witwatersrand to study medicine. The school provides a real ladder out of poverty and the “second economy”.

Mr Mbeki refers to the present time as South Africa's “age of hope”. The students at Sekolo Sa Borokgo give ample cause for hope, but sadly their experience is the exception rather than the rule. By and large, South Africa's education system delivers less than it should, often by an alarmingly large margin. The resulting skills crisis is the single most important thing holding back the country's development.

Nearly all South African children now attend primary school, which for a developing country is good going. The quality of the education is another matter. South Africa compares badly even with other African countries. In an international study in 2003 of young teenagers' proficiency in maths and science, South Africa came last of 50 countries.

The most important statistic, however, concerns the colour of the students. In 2002, the latest year for which figures are available, only 4,637 of the 19,765 students who got higher-grade passes in maths in the matric exam were black. Another study showed that of those who gained matric passes good enough to get them into university in 2003, only 5% were black, compared with 7% coloured, 41% Indian and 36% white—a breakdown barely changed from ten years earlier.

In short, even though the government now spends about 20% of the national budget on education, the old government schools attended by the vast majority of black students are still letting them down. To give them a better chance, many poor parents will go to great lengths to get their children into schools like Sekolo Sa Borokgo, even though it means paying fees.

Too monochrome 5

Highest level of education by race among 20+ year-old South Africans, 2003, %

Race	No schooling	Some/ completed primary	Some secondary	Completed secondary ("matric")	Higher
Black	22.3	25.4	30.4	16.8	5.2
Coloured	8.3	28.2	40.1	18.5	4.9
Asian	5.3	11.9	33.0	34.9	14.9
White	1.4	2.0	25.9	40.9	29.8

Source: Statistics South Africa

Sekolo Sa Borokgo is an independent school, founded in 1993. Its fees are modest, about 6,900 rand a year, but that is still a lot for someone from Soweto. The school is not-for-profit and receives a government subsidy of about 500,000 rand a year (all schools that are teaching disadvantaged children can get government support). The private sector also makes a contribution.

Mixed funding of this sort is increasingly the model for the independent sector in South Africa. It is thriving, reflecting strong demand for better schools than the state can provide. The number of independent schools has grown from 517 in 1994 to about 2,000 today, accounting for about 4% of students. Jane Hofmeyr, the head of the Independent Schools Association of South Africa, points out that the majority of these schools charge fees at the lower end of the scale, below 6,000 rand a year, because many of them were set up by local black communities to cater for their own children. The proportion of blacks in the independent sector has risen from 36% in 1990 to almost 60% today. This sector is now the most racially integrated part of the country's school system.

Parents are increasingly becoming educational entrepreneurs, creating their own avenues of economic and social mobility. They realise that education is vitally important and are ready to make large sacrifices to ensure that their children get the best on offer. But those who benefit still make up only a small minority of the age group. How can the rest of the school system be improved?

The formerly white state schools still do comparatively well. They have a degree of autonomy, charge some fees and get decent results. But between 59% and 77% of the children who attend them are still white, so the best-performing state schools are hardly wide open to blacks.

The majority of the black state schools still perform badly, despite lots of government spending on everything from classrooms to textbooks. The hardest part is to improve the quality of the teachers, which every expert agrees makes the crucial difference. “The learning outcomes will only be as good as the qualifications of the teachers,” says Linda Chisholm, an education expert at the Human Sciences Research Council. Yet stories of drunk, absent or wholly unqualified teachers abound. Indeed, the proportion of unqualified teachers in the system, especially in maths and science, is higher today than it was in 1975. The government has tried to recruit and retain better teachers by offering incentives such as performance bonuses. But, as in richer countries, these reforms have been contested or undermined by the teaching unions.

Still, South Africa has one big advantage over many rich countries: its school system is very flexible, and its schools are relatively free to tailor their offerings to suit their particular students. Every “state” school can charge fees; at the same time, the government willingly subsidises the best in the independent sector for the overall good of the country. Private business also gets involved in funding initiatives across the board. If South Africa can apply the same mix of private initiative and state resources to training a new generation of qualified teachers, there is no reason why the country cannot produce many more Zamas, Brians, Comforts and Glorias.

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The view from the shacks

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Miserable but not quite hopeless

The price of jobs and education

Get article background

A GOOD place to view South Africa's economic development from another angle is the Foreman Road shantytown in the middle of Durban. Here, perhaps a thousand makeshift shacks, thrown together with whatever came to hand—pieces of wood, corrugated iron, bits of cardboard—cling precariously to the muddy side of a steep hill. They are home to 7,000 people.

The number of people living in shantytowns has grown hugely in the past few years. In a relatively prosperous city such as Durban, the largest city in KwaZulu-Natal, shacks are now crammed onto almost every bit of vacant land. Unlike townships such as Soweto, which were designated areas for blacks to live in under apartheid, the shantytowns are spontaneous settlements set up by people fleeing the poverty and lack of opportunity in rural South Africa. With the decline of the old industries such as mining and agriculture, the shack-dwellers come to the big cities in search of jobs.

The rapid, unplanned influx into the shantytowns has caused living conditions to deteriorate. In Foreman Road, residents say there are just five toilets between 7,000 of them, and only four water standpipes provided by the local council. There is no electricity, so the main hazard in Foreman Road is fire, caused by accidents with paraffin lamps. Residents suffer a lot of health problems, mainly stomach and respiratory ailments. Last year the accumulated grievances of the shack-dwellers erupted into protests throughout the country, with clashes between residents and police.

In Foreman Road, people feel betrayed by the ANC and ignored by the local leaders. They say they were promised proper low-cost housing five years ago, but nothing has happened, so last year they organised themselves into a Shack-Dwellers Movement. Their leader, S'bu Zikode, says that

they have been waiting patiently, “but our leaders have betrayed us. Our children will die from fires and disease. We are living like wild animals.”

The ANC has accused the shack-dwellers of being politically motivated. Yet they have endured their dreadful living conditions precisely because they are all working hard to move from the “second economy” to the “first economy”, as Mr Mbeki wants. The shacks may be putrid and dangerous, but they are also much in demand. When one becomes vacant, a family will scrape together up to 500 rand to buy it and get the chance of a job and perhaps even a decent education.

Eighteen-year-old Philani, for instance, has lived in Foreman Road for seven years and has gained his matric exam. He is applying for jobs in sales and marketing. Philani and his peers are just the sort of entrepreneurial people the ANC needs to encourage. Instead, they feel that they are being turned away.

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All together now

Apr 6th 2006
From The Economist print edition

Panos

Public-private partnerships have worked wonders in fighting crime

Get article background

EVERY day, high up in the Carlton building, a prestigious 50-storey tower block in the middle of Johannesburg's Central Business District (CBD), dozens of men and women sit hunched over banks of TV screens, monitoring images coming in from 200 surveillance cameras covering the CBD's entire 30 square kilometres. This is the control room of Cueincident, the brainchild of a consortium called Business Against Crime (BAC). It was set up to co-ordinate the Johannesburg business community's response to the 1990s crime wave that central government seemed powerless to stop, and now has revenues of about 40m rand a year.

In the late 1990s, Johannesburg's CBD deserved its moniker as “crime capital of the world”. Indeed, when Cueincident's people moved into the Carlton in 2000, they found the building empty. All the other tenants had fled to the suburbs, pursued by the muggers, carjackers and assorted petty criminals who had made life in the centre of the country's business capital unendurable.

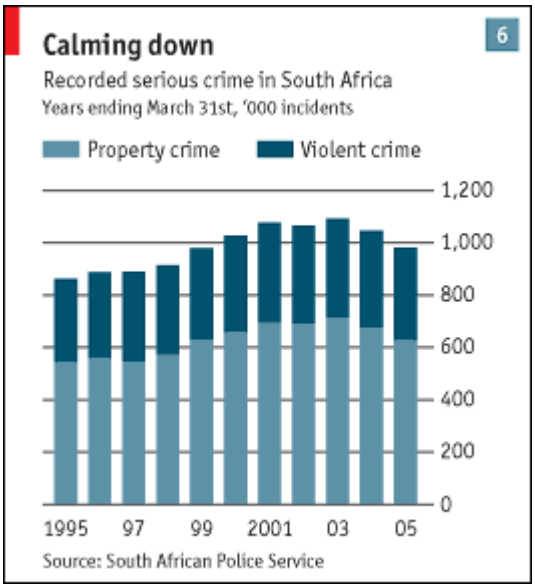
But the past few years have seen a remarkable turnaround. BAC was invited to set up its cameras in the CBD after a similar scheme had worked well in Cape Town, and Cueincident's Neville Huxham says that within 18 months of the arrival of the closed-circuit TV cameras, street crime had dropped by 80%. Bank robberies, once common in the CBD, have become rare. And whereas only a couple of years ago people avoided using their mobile phones in the streets to avoid attracting muggers, they now talk into them with gusto.

The most obvious result of the dramatic reduction in crime in Johannesburg has been the swift regeneration of the city centre. Beginning with the Johannesburg Stock Exchange, by the end of the 1990s much of the business community had moved out of the CBD to the suburb of Sandton, a few miles to the north. The CBD ended up with whole blocks of boarded-up buildings, rubbish piling up and few people in the streets. The big mining houses stuck it out, but at considerable cost. Even the landmark giant bronze statue that used to adorn the entrance to Anglo American's offices, Impala Stampede, was torn down and destroyed by the rampaging gangs.

But around 2003 the tide started to turn. Alfonso Botha was one of an intrepid few property developers who decided to move back into the CBD. He founded a company called Urban Ocean,

bought up the empty, boarded-up buildings cheaply, spruced them up and started converting them into flats, loft apartments and offices. He reckoned that once the CBD was safe again, young professionals would flock back to live there to avoid long commutes. His gamble has paid off. Like others who invested early, he is now a rich man.

The model that BAC has pioneered in Johannesburg—making use of private-sector know-how to combat crime with a mixture of public and private money—is now being applied to all parts of the criminal-justice system. One bottleneck has always been the slow processing of criminal cases. BAC spent 31m rand over several years on getting outside experts to analyse the flow of cases, from the initial reporting of an incident in a police station to the arrival (or not) of the case in court. On the basis of this research, the government spent about 2 billion rand on reforming the whole system. Perhaps partly as a result, conviction rates—a dismal 8% in 2000—are beginning to creep up.



The turnaround in Johannesburg may also have helped to bring down crime in South Africa as a whole. Government statistics look encouraging. The overall murder rate for the country is down by over 40% from its peak in the mid-1990s, and the rate in Soweto by as much as 60%. Violent crime in general has fallen by 8% in the two years to 2004-05 (see chart 6) and property crimes by 11%. The number of car thefts in 2004-05 was the lowest on record.

But there are still areas of concern. Cash-in-transit robberies are on the increase, and there are still huge numbers of firearms in circulation, a legacy of South Africa's apartheid-era wars with its neighbours. The number of licensed firearms in 2004 was almost 4m, with probably a further 500,000-1m unlicensed weapons on top. According to a report by the Human Sciences Research Council, firearms held by civilians outnumber those held by the state security agencies by a factor of six.

400,000 guardian angels

At national level too, the private sector has energetically moved into crime prevention to fill the void left by the state in the 1990s. Official figures show that 265,000 people are now working in the “guarding” business, almost twice as many as in the regular police force. Including people in related occupations, such as private investigators and in-house security guards, the total may be as much as 400,000.

With that sort of investment, it would be astonishing if crime had not come down in the past few years. Yet Antony Altbeker, a researcher on crime and justice at the Institute for Security Studies, argues that government has played a part in the improvement as well. In the mid-1990s the state police force suddenly had to transform itself from an instrument of political repression into a crime-fighting force. Many (mainly white) officers left and numbers dropped, but with better pay they have since risen again, to about 150,000.

The government has also provided some 10m people with pensions and child support. Mr Altbeker, pointing to research showing that about half of all crimes take place between people who know each other, thinks that these grants may have moderated “some of the petty squabbling and

inter-personal violence within families, including murders”.

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Keep chasing

Apr 6th 2006
From The Economist print edition

If South Africa pursues its rainbow vigorously enough, it may find a pot of gold

Getty Images

It's on the horizon

Get article background

IMPALA STAMPEDE, the huge statue outside the Johannesburg offices of Anglo American that fell victim to the gangs, is back now, looking as good as new. Anglo American tracked down the son of the original sculptor and commissioned him to produce a faithful replica. South Africa has come back, too—not only from the trauma of apartheid, but from the difficult years after 1994 when many of the institutions and services of the previous regime had to be reinvented, with all the uncertainty, disruption and job losses that entailed. The timing did not help: just as South Africa emerged from the deep freeze of the apartheid years, it was met by the gale of globalisation blowing through the world economy in the 1990s. The political change hurt the “old economy” of labour-intensive mining and agriculture, heavily protected under the apartheid regime, and hundreds of thousands of poor blacks lost their jobs just as majority rule began.

Against this background, it would have been natural for the ANC to want to carry out its early Marxist promises to nationalise everything and return to a state of economic autarky, turning its back on the world. To its credit, it has not done so, but has largely stuck to free-market policies. As this survey has shown, the government has been refreshingly pragmatic and unideological, experimenting with, or allowing, a mix of solutions in different sectors of the economy.

Things left to do

If only the ANC leadership could be as flexible and liberal when it comes to politics. Over the past few years it has concentrated more and more power in Pretoria, at the expense of the municipalities and the provinces, at the same time as increasing the control it exerts over the

lower ranks of the party. This has begun to produce a backlash among its own supporters, some of whom now feel alienated from the party, and from politics in general.

The party's intolerance of the views of some of its supporters is matched by its general intolerance of ideas from outside its own ranks, for example from the Treatment Action Campaign over AIDS/HIV. The ANC's next leader, who will take it into the presidential campaign of 2009, will need to deal with these issues if the party is to retain the support of a society that now expects high levels of accountability, openness and transparency.

In the longer term, more openness and loosening of control may also lead to a true de-racialising of South Africa. For now, the growth of a black middle class and the more equitable distribution of wealth has been largely confined to the public sector. “Empowerment” has done little to stimulate the private sector. One way of improving matters would be to relax the current tight limits on immigration (imposed to protect black job-seekers) and welcome in people with the skills to create good jobs for the blacks to take up.

The whole economy would also benefit from allowing private firms into sectors such as telecoms, power and transport, currently each dominated by a single provider. The fastest-growing port in southern Africa is not Durban but Maputo, in neighbouring Mozambique, which prospers mainly on the back of South African trade. And as in the rest of Africa, the great leaps in communications have been made by the private mobile-telephone companies, not by Telkom, the largely state-owned fixed-line operator.

With many of its leading politicians discredited, the continent needs a strong South Africa. But it also needs a South Africa that is prepared to go beyond its strictly Africanist agenda, and to deliver on its commitments to good governance, human rights and democracy enshrined in the new vision of the African Union and Nepad. These are very much South Africa's creations. It is time for Africa's leading democracy to cast off its humility and diffidence—and perhaps even to throw its weight around for these causes.

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General Motors, Delphi and the unions

Last tango in Detroit?

Apr 6th 2006 | DETROIT AND NEW YORK
From The Economist print edition

As fears grow that General Motors will go bust, management and unions are locked in a mournful embrace

Get article background

"IN THIS case, it takes three to tango." So said Rick Wagoner, the boss of General Motors (GM), this week—his re-working of an old cliché, capturing the contortions he is having to perform as he struggles to save the ailing giant of the car industry. Given its shrinking market share, GM would be hard enough to revive were it any firm in any industry. But GM is not any old firm, and designing more sellable cars is arguably the least of its problems. These, as Mr Wagoner says, require it somehow to find a way not only to get back on its feet, but also to dance simultaneously with Delphi, its now bankrupt parts supplier, and with one of America's toughest trade unions, the United Auto Workers (UAW). No wonder the firm's share price heads ever lower, and observers talk gloomily about GM stumbling dangerously towards Chapter 11 bankruptcy protection.

Looking at the mess that is GM today, it is easy to forget that for much of its 98-year history it embodied all that was great about American capitalism. Under Alfred Sloan, it pioneered new management techniques, enabling it to overtake Ford Motor Company in the 1920s. By the 1950s, GM had the largest workforce of any company in the free world, and had become the first firm to make $1 billion in a year.

Today, GM is primarily a case study in how the rest of American capitalism might have turned out were it not for the burst of creative destruction, starting in the 1980s, that transformed many industries and ultimately made America home to many of the world's best companies. In a free-market economy where the shareholder is king, GM is a depressing counter example: bureaucratic, union-dominated, increasingly losing out to leaner, better-run competitors, especially from abroad, and paralysed by laws and contracts that stop management doing the

necessary dirty work—sacking workers, cutting wages to market levels and trimming its portfolio of vehicle brands.

The question now is what, if anything, can be done to get GM heading in the right direction again? The priority is to sort out Delphi, which was spun off from GM in 1999. This separation, it now turns out, was never as complete as it seemed: GM remained liable for some costs if Delphi were to go bust. This it did last October, not least because of the high labour costs it inherited from GM. Delphi employees earn three times as much as some other unionised workers in similar jobs on the other side of Detroit—let alone non-union or foreign labour.

Steve Miller, Delphi's chief executive, has been trying, without much success, to win concessions from the UAW. On March 31st he exercised the “nuclear option”, asking a bankruptcy judge to cancel the firm's contract with the UAW, so allowing Delphi to pay wages closer to the industry norm. Such cost-cutting is vital if Delphi is to survive, but, if the judge agrees to it after a hearing on May 9th, Delphi workers may well go on strike.

That could have nasty consequences for GM which—even if it has been building up its stocks of parts—would suffer a costly production slowdown. GM is already losing nearly $1 billion a month. A prolonged strike at Delphi could well force GM into Chapter 11. Delphi's workers know that, and also know that GM is sitting on a vast—though shrinking—mountain of cash, estimated at around $20 billion. They hope that the threat of a strike will prompt GM's management to dip into its cash reserve to compensate them for accepting lower pay and benefits (particularly the gold-plated pension and health-care plans won over the years by the UAW). GM's Mr Wagoner is keen to avoid a strike, and has tabled a modest compensation package—but fears that Delphi workers will demand too high a price.

An even bigger challenge for Mr Wagoner is to wrest big reductions in pay, benefits and employment at GM itself—ideally even before the start of the negotiation of a new labour contract governing Detroit's “Big Three” car companies, due by September 2007. A compensation package recently offered to GM employees agreeing to retire early has been well received, and may help cut the number of workers sitting idle in GM's notorious “jobs bank”. But, almost a year after he took charge of sorting out GM's North American operations, Mr Wagoner is under growing pressure to realise more fundamental reforms.

In particular, Mr Wagoner will need to satisfy Jerry York, a veteran of turnarounds at Chrysler and IBM, who recently joined the board at the behest of GM's biggest shareholder, Kirk Kerkorian. Whether Mr York can make a difference will be an important test of the effectiveness of a new trend in American corporate governance, whereby activist investors such as Mr Kerkorian target underperforming firms and try to revive them by putting their representatives on the board to agitate from within. Despite recent re-statements of GM's accounts, Mr Wagoner has just received a vote of confidence from the GM board—always a worrying sign.

The GM boss also apparently gets on well with the UAW leader, Ron Gettelfinger, who understands the need for GM to lower its costs and respects GM's recent “shared suffering” policy of cutting its dividend in half and slashing top executives' pay. But the union boss is up for re-election in June, and his members are increasingly angry about what they see as his chumminess with GM's leaders.

No one wants GM to end up in Chapter 11, which, at the very least, would involve huge legal costs. Mr Miller pointed out this week that America's steel industry emerged from Chapter 11 in much better shape. But it is hard to argue that the same is true of the airline industry (see article). Moreover, bankruptcy would probably further reduce GM's falling market share (down from 35% in America in 1992 to 25% today), as potential customers would fear that the firm might not be around to deal with any faults in their new cars.

Even so, the leaders of GM, Delphi and the UAW are playing a dangerous game of chicken that could easily result in bankruptcy despite it being in none of their best interests. Edward Altman of New York University reckons there is a one-in-five chance of GM going bust within one year, and a 50% chance of bankruptcy within five years, although those odds will change if the sale announced this week of a 51% stake in GM's financing arm, General Motors Acceptance Corporation, is completed. That sale seems to be a desperate money-raising move, especially as it does not guarantee the higher bond rating for GMAC that GM sought so as to minimise the financing arm's cost of capital. In addition, the buying consortium led by Cerberus Capital can walk away if GM's own bond rating gets even junkier. A successful sale will reduce the odds of GM going bust in the short-term, but make it even likelier in the long-term, says Mr Altman.

The reason is that GM's cash mountain is not so much an asset, but something for the UAW to fight over. Selling the stake in GMAC adds to the available cash. That is likely only to postpone the day of reckoning and may thus prove a huge and costly mistake, says Dale Oesterle, a law professor at Ohio State University. Far better, he thinks, would be for GM to seize the day by handing its cash mountain back to shareholders in the form of a special dividend, and filing for Chapter 11 right away.

That is an easier call to make from the lecture theatre than the boardroom. More likely is that for a few more years yet, everyone will suffer as GM's remorseless decline goes on.

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Bankruptcy

Don't feed the zombies

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From The Economist print edition

What Japan can teach America about coddling companies in debt

THE big complaint against many troubled American firms these days—from airlines to makers of car parts—is how they use bankruptcy to weasel out of pension promises and union contracts. But protecting firms from the need to take radical action can have even worse long-term consequences. Anyone who doubts it should look at the experience of Japan in the 1990s.

Japan's “lost decade” followed a nasty collapse of property and share prices. But the subsequent debt and deflation did not have to drag on for so long. The problem was that Japan's weakest firms—especially in non-manufacturing industries isolated from global competition—were subsidised by badly regulated banks. Those “zombie” companies then damaged the profitability of healthy rivals, making entire industries sick. The process is laid out in gruesome detail in a new study by three economists: Ricardo Caballero of the Massachusetts Institute of Technology, Takeo Hoshi of the University of California at San Diego and Anil Kashyap of the University of Chicago (“Zombie lending and depressed re-structuring in Japan”, NBER working paper, March 2006).

The trio define a zombie as any Japanese firm that got fresh bank loans at cheaper interest rates than the risks warranted—ie, subsidised credit. Banks were throwing good money after bad in this way because twisted regulations made it simpler to prop up weak borrowers than cut them off.

The results were perverse. First, the sectors with the most zombies ended up losing the fewest jobs during the late 1990s, in seeming defiance of market forces. Productivity in those sectors also fell more than it needed to, because unproductive firms kept operating and productive new ones failed to emerge. Even worse, healthy firms in zombie-infected industries did not invest and expand because the zombies lingered on—driving down prices, keeping workers in unproductive jobs and, say the authors, “more generally, congesting the markets”.

American banks do not lend money in such distorted ways, but the country's flawed bankruptcy system can have similar effects. Indeed, the perverse effects of bankruptcy law have been a standard complaint of American airline executives for many years—except, of course, when their own firms are the ones being propped up by “Chapter 11” bankruptcy protection.

But the system seems to be improving. In the 1980s, says Edward Morrison of Columbia law school, bankruptcy let entrenched managers at troubled firms avoid restructuring: for an example, he points to Eastern Airlines, which kept flying and wasting capital at cut-throat rates while in bankruptcy. However over the past ten or 15 years, he argues, creditors have become much more powerful, and can now push through real restructuring plans reasonably quickly.

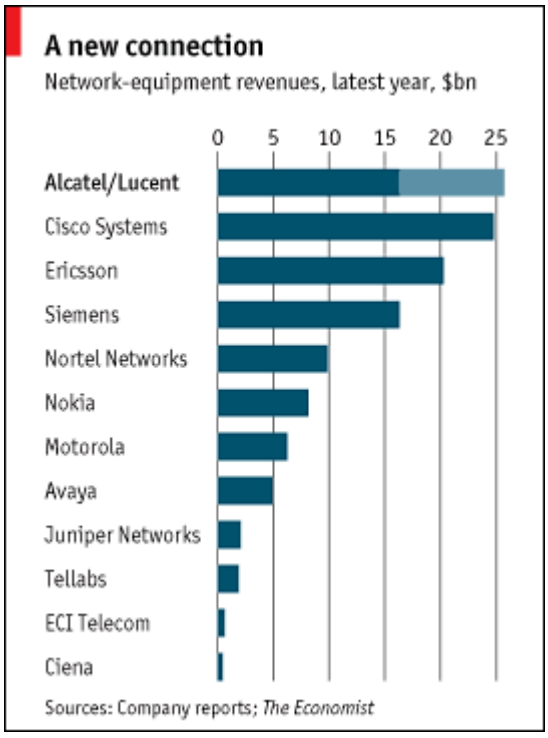
Still, says Mr Kashyap, America's airlines are adapting to reality too slowly. He reckons that Southwest Airlines, a low-cost and highly profitable carrier, would have gained far more market share by now if the industry were not cluttered with zombies.

Alcatel and Lucent

The urge to merge

Apr 6th 2006
From The Economist print edition

Will more big deals follow as telecoms-equipment firms consolidate?



"THIS truly is a defining moment for our industry," said Patricia Russo, the boss of Lucent Technologies, a big American telecoms-equipment firm, as she and Serge Tchuruk, her opposite number at Alcatel, a French equipment-maker, announced a merger on April 2nd. Corporate chieftains love "defining moments". But it is true that combining Alcatel and Lucent will create one of the world's largest suppliers of networking gear by revenue, rivalling Cisco (see chart). A deal on this scale has been expected for some time, thanks to the flurry of mergers among their customers, particularly network operators in America and Europe. Some see it as the beginning of a long-awaited consolidation of equipment-makers—which are competing for a dwindling pool of customers as the operators team up—with many observers predicting a "domino effect" of further huge mergers.

The Alcatel-Lucent deal has been a long time coming. The two firms tried to merge in 2001, but the deal fell apart at the last minute when Lucent's previous boss, Henry Schacht, refused to agree to Mr Tchuruk's terms. But now that agreement has been reached, Alcatel will, in effect, acquire Lucent in an all-share deal worth €30 billion ($36 billion) that values the American firm at $13.5 billion. The merged company (which has yet to be named) will have its headquarters in Paris; Ms Russo will be chief executive and Mr Tchuruk chairman. To help allay political objections, a subsidiary will be created by Lucent to handle its sensitive work for American government agencies, and Alcatel's satellite division will be sold to Thales, a military-electronics firm part-owned by the French state, in a deal worth €1.6 billion ($2 billion).

The merger is predicted to lead to cost savings of $1.7 billion a year within three years, as the two firms eliminate overlapping administrative, procurement and marketing costs and lay off around 10% of their combined workforce of 88,000. The vast reach and scale of the combined firm, said Mr Tchuruk, will provide "the answers to the ongoing consolidation of the global service providers".

So does that mean other equipment-makers will now follow suit and team up to create rival giants? Not necessarily. "It's quite an unusual deal, and I don't expect it to be followed by other big announcements in the very short term," says Jean-Charles Doineau of Ovum, a telecoms consultancy. That is because other equipment-makers seem to have concluded that the best way to rationalise the industry is through smaller acquisitions rather than huge mergers. Such deals

have, in fact, been going on for some time: last year Ericsson bought Marconi, Cisco bought Scientific-Atlanta, and Siemens sold its handset division to BenQ; just last month, Lucent bought Riverstone Networks.

Per Lindberg, an analyst at Dresdner Kleinwort Wasserstein, says that these complementary deals, where a smaller firm's technology is slotted into the portfolio of a large firm, make more sense than big mergers. Alcatel and Lucent, he notes, are underperforming firms with cumbersome product portfolios that overlap in many areas—but they cannot kill off duplicate products, since their existing customers expect them to be supported for years to come. “This merger will not work, operationally, strategically or politically,” he says. “I don't believe megascale mergers will work in telecoms.”

Rather than more big deals, then, the industry's continuing consolidation will probably take the form of further strategic acquisitions by the biggest firms—Juniper, Ciena, ECI Telecom and Tellabs look like probable targets—and some divestments, as companies decide to focus in particular areas. Motorola, for example, which this week sold its automotive-electronics business, must decide whether to beef up or cut loose its network-equipment unit, suggests Tal Liani of Merrill Lynch; Siemens faces a similar choice. Another alternative to big deals, says Mr Lindberg, is partnerships, such as Nortel's joint ventures with LG of South Korea and Huawei of China. Alcatel and Lucent's proposed merger highlights the shake-out that is now under way, but it is far from certain that other telecoms-equipment firms will necessarily follow suit.

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Japanese airlines

Runway rivals

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The contrasting fortunes of Japan's top two airlines

AFP

ON APRIL 4th a pilot from Japan Airlines (JAL) got caught in Kobe traffic and left two planes grounded, forcing passengers to switch to All Nippon Airways (ANA), its rival. It was nothing more than a mishap—except that JAL has recently also had engines bursting into flames, tyres falling off its planes, and an uncomfortably high number of small accidents.

JAL's fortunes are suffering off the runway, too. In March a boardroom coup, played out in the media in a most unJapanese fashion, ousted the firm's then president, Toshiyuki Shinmachi. The new boss, Haruka Nishimatsu, a neutral figure in the bitter battle, which ended with resignations on both sides, may struggle to regain control. JAL is saddled with almost ¥2 trillion ($17 billion) in debt and is expecting to lose money this year. The company's second-largest shareholder recently delivered a damning vote of no confidence, by selling half its ¥50 billion holdings.

By contrast, ANA, the number two carrier, is enjoying a burst of prosperity. Last month it raised its estimate for net profits for the year to March 2006 to ¥23 billion—35% more than forecast in January. Last year its weak international division made money for the first time in 20 years. A reputation for superior service is helping ANA lure passengers from JAL.

The companies' differing circumstances today can partly be explained by their origins more than 50 years ago. JAL was founded in 1951 as Japan's flag-carrier and—although it was privatised in 1987—still bears a hint of public-sector complacency, based on a belief that the government will never let it fail. Shades of its past can also be seen in its reputation for lacklustre service.

ANA, by contrast, has always been in the private sector. Created in 1952, it initially concentrated on low-margin domestic flights, where JAL had smaller operations—eventually building up its Japanese market share to roughly 50%. JAL's much larger international operations meant that ANA had no choice but to run a smaller global network, which has been in the red for 18 of the past 20 years, dragging the company into an overall loss more often than not.

But the fact that its operations were small and unprofitable forced ANA to confront its problems. It cut costs swiftly when the industry faltered after the attacks of September 11th 2001—slashing jobs, closing loss-making routes, reducing the number of flights, and switching to smaller aircraft on its international flights. The SARS health-scare and rising fuel costs strengthened ANA's resolve, and it shed some non-airline ventures.

By contrast, JAL, a deeply splintered company with poor internal communications, was unable to cut costs so quickly. ANA's two house unions agreed to accept 5% wage cuts in 2004. JAL, which has to deal with nine internal unions, has only just persuaded its biggest union to agree to a larger wage-cutting deal. Although some other unilateral wage cuts will be imposed by managers from April 1st, JAL still has eight more unions to deal with—and darkening skies lie ahead.

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Investor activism

The Dutch discount

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A shareholder revolt in the Netherlands

Reuters

Twisting in the wind

WHEN a consortium of private-equity firms offered in January to pay up to €7.3 billion ($8.8 billion) for VNU, a Dutch business-information firm, the company's bosses welcomed the bid. New owners, they hoped, would at last bring some stability to a firm that has been in turmoil since last November, when shareholders forced VNU to scrap a plan to buy IMS Health, an American health-market research firm. As it turned out, the opposite has happened: the private-equity bid has provoked a new shareholder campaign that could turf out the entire supervisory and management board.

The upheaval at VNU is yet another example of increasing shareholder activism in Europe. Last year a group of foreign investors ousted Werner Seifert as boss of Germany's stock exchange, an act that Mr Seifert rails against in “Invasion of the Locusts”, his memoir published on April 3rd. In France a group of investors led by Vincent Bolloré, a French corporate raider, toppled Alain de Pouzilhac as boss of Havas, a big advertising agency. And two of the investors who were part of last year's coup at Havas recently bought a big stake in Vivendi, a French media group—which could herald the beginning of another campaign to force big changes to a company's strategy or its top management—or both.

Investor activism is particularly on the rise in the Netherlands, fuelled by changes in Dutch and European law. Stork, a technology company, is under pressure to de-list from the stock exchange. CSM, a food-ingredients group, has been targeted for its treatment of shareholder voting rights. Investors at Heineken are complaining about the brewer's ownership structure. “In the past Dutch companies were undervalued because of their poor governance,” says Hans Slob at Rabo Securities in Amsterdam. But the “Dutch discount” has been decreasing in recent months.

At VNU, some investors are unhappy with the private-equity offer, published on April 3rd in a memorandum of more than 200 pages from a consortium of six firms including Kohlberg Kravis Roberts and Blackstone. The rebels are led by Knight Vinke Asset Management (KVAM), a small but belligerent investor that had been one of the forces behind the failure of the bid for IMS. Knight Vinke commissioned a report by the Boston Consulting Group to prove its contention that the consortium's offer undervalues VNU by at least 25%—and maybe as much as 40%. It intends to reject the bid and wants other shareholders to do the same. Any sale would need to be

approved by the overwhelming majority of investors.

Shareholders at VNU have until May 5th to decide. KVAM is confident of victory. Fidelity, one of the company's largest shareholders, is unlikely to back the consortium's bid. But is KVAM really acting in the interest of all investors? A rival bid is unlikely to emerge and the company's top management is in turmoil. After the failure of the bid for IMS, the chief executive and other members of the VNU executive board are planning to resign. No replacements have yet been found—perhaps because few people are keen to join a company with such an uncertain future. Maybe a stint under the ownership of demanding private-equity companies would be VNU's best bet.

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Mining

The shedding giant

Apr 6th 2006 | JOHANNESBURG
From The Economist print edition

Why Anglo American is selling some of its parts

THE slimming regimen announced last October has now started in earnest for Anglo American. Last month the mining giant announced that it would reduce its shareholding in AngloGold Ashanti—the third-largest gold producer in the world—from 51% to somewhere between 41% and 42.6%, depending on demand. Other subsidiaries, from paper and packaging to steel, are expected to disappear soon from Anglo American's books. This is the latest instalment of the group's protracted plan to transform itself from a diversified South African behemoth into a global company focused on mining.

In the early 1990s Anglo American was involved in everything from mining to finance, media and beer. The end of apartheid created new opportunities for Anglo as the world suddenly opened up to South African companies; but it also brought global competition and pressure to support the emergence of black business. Anglo American started selling assets, cleaned up its complicated holding structure, and expanded abroad. In the late 1990s it moved its headquarters and primary listing to London to draw on a bigger pool of capital. Today, more than 55% of the group's operating profit is generated outside South Africa.

However, Anglo American still has interests in a range of industries that have little in common. So in October the group announced that it would further focus on mining. It would spin off Mondi, the paper company that generated 8% of the group's headline earnings last year, and sell Highveld Steel. Its interests in sugar and aluminium are likely to share the same fate.

But why is a company keen on mining getting out of gold? The answer is that at the moment, the market places a big premium on the shares of companies such as AngloGold Ashanti, which are pure “gold plays”. Since AngloGold Ashanti's “gold premium” is not fully reflected when it is folded into Anglo American, it makes financial sense for Anglo American to sell some of its shares to unlock that premium. Accounting rules mean that once its share of AngloGold Ashanti falls below 50%, the value of that holding can be reflected in its books at market price, as an investment.

Furthermore, AngloGold Ashanti has embarked on its own cash-raising exercise and it intends to issue $500m of new shares. It would have cost Anglo American hard cash to retain its controlling stake. In any case, Anglo American and its subsidiary have different appetites for risk these days. AngloGold Ashanti is venturing into difficult places such as the Democratic Republic of Congo.

For all that, Anglo American is adamant that it wants to remain a substantial minority shareholder in AngloGold Ashanti, which generated 3% of the group's headline earnings last year. With the majority now up for grabs, however, it could change its mind if potential suitors materialise with attractive offers. For the moment, the 10% slice for sale is expected to bring in between $850m and $1 billion. There have been rumours that Mondi, the $8 billion subsidiary supposed to be listed this year or next, may actually be bought before it reaches the stock exchange. The sale of

Highveld Steel—thought to be worth about $1.1 billion—is well under way. Anglo American's sugar interests could yield an extra $900m. This is no small shedding exercise, even for a £36.2 billion ($63.3 billion) company.

How is Anglo American going to spend this bounty? It says the money will be used to reduce debt, finance investments, and buy back shares. But the bulk is likely to be spent on investments. So far, $6.7 billion worth of projects, mainly in mining, have been approved for the next four years, with another $10 billion-15 billion being considered for the more distant future. The group, which over the past decade has acquired even more than it has sold, may also be thinking of buying new businesses that fit its mining profile. If the company keeps too much cash on its books, it could itself become a mouth-watering acquisition target.

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Romania

No gold please, we're Romanian

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A gold mine excites suspicion

A FOREIGN investor promising up to 1,200 jobs and a $2 billion boost to a poor country is normally welcome. But not when the investment is a gold mine, and the country is Romania.

The investor is Gabriel Resources, a Canadian mining company. It has been trying since 1997 to develop Rosia Montana, a region in northern Romania that, it reckons, contains 10.6m ounces of gold and 52m ounces of silver. This month Gabriel is due to publish a much-awaited environmental-impact assessment of the project.

Under communism, mining in Rosia Montana (as, indeed, everywhere else) was carried out without the least regard for the environment, or the region's archaeological heritage. The area is now badly polluted with cadmium and other heavy metals. In 2000 a cyanide spill from another mine in the region contaminated a river that flows into Hungary. That makes Romanians, normally apathetic about such things, twitchy about any new mining there—especially if it, too, involves cyanide, as the new project will.

The company has tried to assuage these worries. It says it has spent $160m on preparatory work, including advertising campaigns to highlight its high-tech and ultra-clean approach to mining, and on environmental and archaeological projects. It promises more once mining starts. But that has done little to convince the protesters. They are a mixed bunch, including anti-globalisation and Green idealists, as well as some dodgier characters who regard opposition to the project as a way of demonstrating their public-spiritedness.

A report in 2004 for the Council of Europe by Eddie O'Hara, a British MP, described the opposition to the project as “in part exaggerated” and “very much fuelled by outside bodies, presumably well-meaning, but possibly counter-productively”. The environmental objections “do not take account of modern mining techniques...in fact the project will help to clear up existing pollution.”

There are strong arguments in favour of the mine, though they rarely get a hearing in the partisan and excitable Romanian media. Average incomes in the region are only one-third the national average (itself a measly $270 a month). More than half of the workers there are unemployed; that will rise to 90% once another communist-era gold mine closes later this year. In a village of 2,000 people that will have to be demolished (the company plans to rebuild a modernised replica 5km away) more than half the homes lack running water. Some 42% of the villagers have already sold their homes to the company.

A local mayor, who supports the mine, was recently re-elected with a huge majority. Candidates opposed to the mine polled less than 10%. Romanian do-gooders may relish bashing multinationals. But the people directly affected see it otherwise.

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Face value

Still changing the subject

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Sun's chairman and chief executive thinks slogans are a substitute for strategy

Getty Images

SCOTT McNEALY, the boss of Sun Microsystems, a struggling maker of enterprise computers, was on stage again the other day. The occasion was entitled “The Economics of Sharing: A Participation Age panel discussion”, and was meant to be a display of “thought leadership”. Sun had invited a professor, a consultant, a venture capitalist, a pioneer of micro-lending in poor countries, as well as your correspondent, who moderated the debate. The first question went to Mr McNealy, who argued that Sun, which “could have become the next Microsoft” at various points in its 24-year life, had instead always chosen to remain true to its belief in sharing, which all forward-looking companies should now adopt. The other speakers then proceeded to agree that, yes, participation is good and sharing is good—in lots of industries and lots of places.

“Participation” is certainly all the rage—consider the role of blogging and podcasting in the media industry, for example, or the effect of open-source software on the technology industry. But it is not clear that Sun has anything special to contribute. The Sun-sponsored panel on the “Participation Age” and associated slogans looks “like another attempt to change the subject,” mused one of the panellists afterwards.

The subject that needs changing, from Mr McNealy's point of view, is this: during the dotcom

boom of the late 1990s, Sun was the preferred maker of the powerful server and network computers that “new-economy” companies bought in bulk with the money that venture capitalists were throwing at them. Mr McNealy thus became an emblem of the internet boom. He captured the *Zeitgeist* with two great slogans, proclaiming that “the network is the computer” and boasting that Sun (as the supplier of the machines that ran the internet) was “the dot in dotcom”.

Then the boom turned to bust, and suddenly hardly anybody wanted to buy computers—least of all those made by Sun. That was because Sun had been stubbornly ignoring an industry trend toward low-cost, standardised hardware and software that customers could buy piecemeal and patch together. Sun's rivals—such as Hewlett-Packard, IBM, Dell, Intel and Microsoft—had embraced this trend and happily made whatever pieces they were good at. But Mr McNealy, who was one of four co-founders of the company in 1982 and became chief executive at the age of 29, insisted on a complete, proprietary Sun “solution” based around Sun's own processor chips (called Sparc) and operating-system software (called Solaris). It was an all-or-nothing proposition for customers. Many customers chose nothing.

Partly as a result, Sun's revenues have been declining steadily. In 2001 Sun pulled in $18 billion in sales; that fell to $11 billion last year. The company has been making losses for the past four years, and is expected to lose money again this year and next. Sun, not Microsoft, has become the clear loser from the rise of Linux, the open-source operating system, which many customers are using to replace their old Sun systems.

For a long time Mr McNealy was in denial. Anybody who asked would be treated to his analogy with cars (Mr McNealy comes from a car family in Detroit, and named his sons after car models). When buying a car, do you buy the carburettor, the tyres, the exhaust and all the other bits separately, then cobble them together? Of course not, the critic would concede; one buys a whole car. So Mr McNealy won his arguments—but lost his customers, who had come to the conclusion that computers were in fact nothing like cars.

Gradually, Mr McNealy came around to the new way of doing things. Always a good sport, he mounted a stage in 2002, dressed as a penguin (the mascot of Linux) to announce that he would offer Linux on Sun servers. He struck a deal with AMD, a chipmaker that is the main rival to Intel, so that Sun could supply computers built around AMD's chips in addition to its own Sparc chips. Mr McNealy bought a company—which had been started by Andy Bechtolsheim, another of Sun's four founders—that made computers based on industry standards, the antithesis of Sun's approach. He bought a large data-storage company, too.

So little time, so many stages

To his chagrin, none of these moves won over his critics. So, more stages were mounted. Mr McNealy hugged and swapped hockey jerseys with Steve Ballmer, the boss of Microsoft, a firm he had always loved to hate. He got up on a stage with Eric Schmidt, who used to work for Sun, but is now chief executive of Google, a much sexier technology company that fascinates the press—but it turned out that the two men had nothing in particular to announce.

Mr McNealy then made two gestures that he considers shockingly bold. Last year he made Sun's operating system, Solaris, open-source, so that—as with Linux—anybody can in theory use it free (though in practice, customers usually pay service fees for maintenance). Earlier this year Sun went one better and also made the design of its Sparc chip open-source—a rare example of open-source extending to hardware. Surely these two actions proved that Mr McNealy not only preaches the “economics of sharing” but practises it, too?

Unfortunately, none of this visionary stuff seems to be helping Sun. All the changes Mr McNealy

has made since 2002 have been attempts to convince customers that buying gadgets from Sun was no longer an all-or-nothing proposition. But too many customers have become used to listening to and doing business with Dell, HP and IBM instead. Rob Enderle, who runs an eponymous technology consultancy, says that Sun is “like a soccer team that suddenly shows up in the Super Bowl against an [American] football team.” Mr McNealy's slogans are usually right. The network really is becoming the computer. An age of participation may indeed be dawning. The trouble is that Sun, the company, may not be there to witness it.

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Correction: Wikipedia

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In "Open, but not as usual" (March 18th), we said non-registered users could not modify most Wikipedia entries; they can, save for some controversial ones. Also, a chart of Wikipedia's articles and contributors incorrectly showed a downturn in December 2005, because we used incomplete data (this was corrected online). We apologise.

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The new paternalism

The avuncular state

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A smarter, softer kind of paternalism is coming into style

THE *Admiral* is one of 11 riverboat casinos on the waterways of Missouri, where riverine gambling was legalised in May 1994. The casinos attract more than 25m visits a year. But close to 10,000 people are barred for life from gambling on the riverboats. If they breach this ban, they face arrest for trespassing and the confiscation of their winnings. These riverboat exiles are not cheats or paupers. Rather, they suffer from a gambling compulsion—a ruinous addiction to risk. The state of Missouri is stopping them for their own good.

> If gambling, or drunkenness, or incontinence, or idleness, or uncleanliness, are as injurious to happiness...as many or most of the acts prohibited by law, why (it may be asked) should not law...endeavour to repress these also?

A good question, which John Stuart Mill, who raised it in 1869, endeavoured to answer in his essay against paternalism, “On Liberty”. Mill's answer was that the state should repress a man's acts only if they harm others. Harm to himself alone was not a good enough reason for the state to limit his freedom.

Mill would have thrown his book at the state of Missouri, then? Perhaps not—because the people it bars from the riverboat casinos freely chose their own exclusion. Since 1996 Missouri has pioneered a scheme that allows self-confessed gambling addicts to add their own names to a voluntary blacklist. Once on the list, they can never come off it. The scheme allows tormented people to enlist the state's help in their internal battles—to give force of law to the angels of their

better nature.

Such policies appeal to a group of scholars—John Beshears and David Laibson of Harvard University, James Choi of Yale and Brigitte Madrian of the Wharton School—who espouse a fashionable branch of the dismal science known as behavioural economics. The behaviouralists claim to understand people as they are, not as economists hitherto assumed them to be. Because of ignorance or intemperance, lack of willpower or brainpower, people choose badly. Predictably so. The subdiscipline now has a well stocked cabinet of horrors and curiosities, showing how people fail to exercise their choices in their own best interest.

Having documented people's inadequacies, the behaviouralists now want to save them. The iconoclasts are becoming paternalists—but of a distinctive kind. Two of them, Cass Sunstein and Richard Thaler of the University of Chicago, describe their approach as “libertarian paternalism”, which, they insist, is not an oxymoron. Their critics, such as Edward Glaeser, of Harvard University, call it “soft paternalism”. Whatever the label, their approach is cannier and stealthier than the heavy-handed paternalism liberals reject. Their aim is not the “nanny state”, a scold and killjoy forcing its charges to eat their vegetables and take their medicine. Instead they offer a vision of what you might call the “avuncular state”, worldly-wise, offering a nudge in the right direction, perhaps pulling strings on your behalf without your even noticing.

One example of soft paternalism has already attracted the interest of governments and the backing of this newspaper: employees should be signed up for company pension schemes by default. Such schemes, which typically attract tax breaks from governments and matching contributions from employers, are usually in the best interest of workers. You might say that joining is a “no-brainer”, except that what little brainwork and paperwork is required defeats a surprising number of people. A soft paternalist would presume that people want to join, leaving them free to opt out if they choose. In one case study by Ms Madrian and Dennis Shea, changing the default rule in this way raised the enrolment rate from 49% to 86%.

This measure exemplifies the soft paternalists' approach: the error it addresses is glaring, the remedy unobtrusive. The switch in default rules alters behaviour while preserving freedom of choice. It spares the ignorant and the dilatory from the consequences of their mistakes, while imposing few costs on those who genuinely prefer not to entrust their pension money to their employer's custody. This, say Messrs Sunstein and Thaler, makes it both libertarian and paternalistic.

Lord, give me thrift, but not yet

If inertia explains why people fail to join pension schemes in the first place, improvidence explains why they save so little when they do. Figures from some American schemes suggest workers are contributing less than 7% of their incomes on average. And those automatically enrolled in the pension studied by Ms Madrian and Mr Shea tend to stick with the low, default contribution rate of about 3%.

Nannyish governments, not all of them very thrifty themselves, are exhorting the public to do better. “The American Dream begins with saving money,” said Dick Cheney, America's vice-president, at last month's Saver Summit, “and that should begin on the very first day of work.”

The new paternalists beg to differ. Mr Thaler and Shlomo Benartzi, who is from the University of California, Los Angeles, are urging Americans to “Save More Tomorrow”. That is the name of their canny proposal to tempt workers to commit themselves today to saving later.

Under their scheme, a fraction of workers' future pay increases is diverted into their pension pot before arriving in their pay packet. People seem readier to part with tomorrow's cash than today's; and as long as they hike their saving rate by less than their pay raise, their extra thriftiness will not feel like a cut in their disposable income. Messrs Thaler and Benartzi put their scheme to the test at a medium-sized manufacturing company. After four annual pay rises, the joiners had raised their saving rate from just 3.5% to fully 13.6%. “We plead guilty to the charge of trying to be paternalistic,” the authors write. But since they have not infringed on freedom of choice, they do not think it a crime.

The two authors spelt out their plan in an article from 2004 dedicated to the late Sherwin Rosen, Mr Thaler's thesis adviser. “He would not have liked this paper much,” the authors write in their acknowledgments, “but we sure would have enjoyed hearing him complain about it!”

What complaints might he have made? Some economists feel about the behaviouralists much as Robert Frost felt about writers of free verse: economics without rationality is like tennis without a net. It is too easy. If appeals to irrationality are admissible, then anything goes. But behavioural economics has grown up, and part of its maturation is to show that no, not anything goes. People depart from rationality, but they do so in ways that can be predicted—and exploited. Unlike free verse, their behaviour has some rhythm and regularity.

A lack of self-control is one such regularity. Impatience has always been a part of economics: people don't like to defer gratification, and they demand compensation—an interest rate—for doing so. The behaviouralists, however, have shown that people are inconsistent about their impatience. It takes one rate of interest to make them settle for a reward tomorrow rather than today, quite another to leave them indifferent between a reward 1,000 days from now, and one 1,001 days from now. For the second kind of choice (jam later, or later still) people are quite patient, accepting an annualised interest rate of 4.3% on average, according to a recent study by Mr Laibson and others. But for the first kind of decision (jam now, or later) people are much more impatient, demanding a rate of interest equivalent to 40% a year.

This inconsistency applies to chores as well as treats, as Ted O'Donoghue of Cornell University and Matthew Rabin of the University of California, Berkeley, point out. Suppose you must either do seven hours of gruelling paperwork on May 1st or eight hours on May 15th. If asked in March, most people would prefer the seven hours. But if asked on May 1st, most would put off the work for a further two weeks. Translated into the realm of personal saving, this is precisely the quirk in our nature that Messrs Thaler and Benartzi exploit when they ask people to save more—not today, but tomorrow.

This quirk sets up an “intimate contest for self-command”, as Thomas Schelling, a winner of last year's Nobel prize for economics, puts it. People act as if two different selves take turns to run the show. Resolutions founder, because the self who decides to quit drinking or start a diet in the new year is not the self who must act on that resolution when the day arrives.

Mr Schelling's own intimate contest is with smoking; he is torn between a self who craves nicotine and a self who wants to be free of it. His habit has been a tempting target for paternalists, soft and hard. A new temperance movement of surprising force has banished smokers from offices, restaurants and bars in a lengthening list of countries. This year, even Spain banned smoking in workplaces.

The anti-smoking leagues stay on the right side of Mill by invoking the dangers of passive

smoking. The true extent of those dangers is a matter of some uncertainty. But they represent a classic externality—an uncompensated, unpriced harm the smoker inflicts on others—which can justify quite draconian measures even in a liberal's eyes.

Some of the new paternalists, however, justify smoking restrictions on less orthodox grounds. Just as one individual can inflict an externality on another, so one side of a person's nature can inflict an “internality” on another. The self who enjoys a cigarette takes too little account of the damage he inflicts on the lungs of his future self, nor the addition each cigarette makes to the strength of his addiction.

Jonathan Gruber of the Massachusetts Institute of Technology, and Botond Koszegi of the University of California, Berkeley, think these “internalities” justify additional “sin taxes” on cigarettes and alcohol. Such taxes are not, they claim, unfair to the poor, who spend a greater share of their income on cigarettes. Since the poor are more sensitive to prices than the rich, higher tobacco taxes are of greater help to them in their efforts to quit. Taking this into account, cigarette taxes are probably “progressive”, the two economists conclude.

Messrs O'Donoghue and Rabin, on the other hand, suggest sin licences. Rather than charge a duty of $2 a packet, governments could make the sale of cigarettes illegal to anyone who did not buy a smokers'ID, which might cost $5,000 and entitle the holder to 2,500 packets of cigarettes tax-free. People would no longer be able to slide into a smoking habit one packet at a time. It would be clear from the outset that they were entering a lifelong marriage to nicotine.

If such a high price is too crude a deterrent, the sin licences could instead carry customised restrictions, argue Mr Beshears and his colleagues. The licences would be sold for a nominal fee, but holders could specify in advance how many cigarettes they were allowed to buy, and at what times. Those restrictions could be loosened, but any tinkering would come into effect only after a lag, of say three days. The licences would be only a minor inconvenience to people who plan to smoke a lot. But they would be of great help to people who plan not to smoke, but find themselves with a cigarette at their lips in spite of their pledges to give up.

Should liberals object to schemes of this kind? Perhaps not. By helping people to make forward-looking decisions for themselves that they cannot easily renege on later, they enlarge their freedom, making it possible for them to do things they otherwise could not do. Giving Ulysses the rope with which to lash himself to the mast adds to his choices.

But Glen Whitman, of California State University, has doubts. In an engaging tract for the Cato Institute, a libertarian think-tank, he wonders why governments should always favour the long-sighted self over its near-sighted alter ego. The immediate pleasures of gambling, drinking and idleness are real; so too are the costs of suppressing them. “In contrast to the obese and the profligate, whose short-run selves constantly trump their long-run selves, we might point to the misers [and] workaholics for whom the reverse appears to be true,” he writes.

Ignorance is not an option

Public health campaigns are a more traditional weapon against smoking. In America these began with the surgeon general's report on smoking and health in 1964, but they have come a long way since then. The Canadians, for example, have decorated cigarette packets with repellent images of blackened gums and cancerous lungs. New York's Museum of Modern Art celebrated one of these images in a recent exhibition of designs that “protect body and mind from dangerous or stressful circumstances”. The packet didn't just warn smokers of the risk of impotence, it illustrated the danger with a bent cigarette, hanging limply.

Even the most ardent liberal is happy for governments to provide information or force others to do so. A doctor should tell his patient about the risks of elective surgery, for example. To leave the patient in the dark would be criminally negligent.

But how should the doctor frame the patient's choice? Should he tell him that 90% of those who undergo the procedure survive? Or that 10% die? Both statements convey identical information. But each has markedly different effects on behaviour.

Such dilemmas are not purely hypothetical, as Mr Sunstein and Christine Jolls, of Harvard Law School, point out. In 2003 America's Health and Human Services Department commissioned a campaign to promote breastfeeding. The original version of the adverts warned that, without breastmilk, children ran a heightened risk of leukaemia, diabetes and respiratory diseases. (They showed pregnant women roller-skating or riding bucking broncos. You wouldn't take risks before your baby was born, the adverts intoned. Why start now?) Infant-formula makers objected, arguing that the adverts should stick to the benefits of breastmilk, rather than the dangers of not breastfeeding.

How information is framed matters. People weigh losses more heavily than gains, as Messrs Thaler and Benartzi explain. They will typically bet on a coin toss only if their potential winnings are twice as big as the amount they stand to lose. Likewise, mothers will go to greater lengths to avoid the harm a lack of breastmilk might inflict than to secure the benefits breastfeeding can bring. It is not for the state to decide how mothers should feed their children, the antipaternalist would argue. But if the state is to provide any information at all, it will also steer people, whether it wants to or not. “It is far too simple, and behaviourally naive, to draw a sharp line between acceptable ‘provision of information’ and unacceptable ‘mind control’,” argue Ms Jolls and Mr Sunstein.

This acute sensitivity to losses is not the only bias behaviouralists have discovered. People also have great difficulty understanding risks. The weight a person gives to a scenario—flood, fire, winning the lottery—should depend on its likelihood. In fact, it depends on how easily it can be envisaged. People will pay more for air-travel insurance against “terrorist acts” than against death from “all possible causes”. Canny governments can work with the grain of this psychology. The grisly campaigns against smoking aim to put the dangers firmly in people's minds; to turn a statistical risk into a visceral image. They have been effective, perhaps too effective. There is some evidence that people now overestimate the risks of smoking.

But such campaigns can also have nasty side effects, Mr Glaeser argues. The fear, shame and guilt they inculcate acts as a kind of “psychic tax”, reducing the demand for smoking. But unlike a genuine sin tax, which shifts money from taxpayers to the treasury, psychic taxes impose emotional costs without raising revenues. By portraying a habit as self-destructive and therefore shameful, such campaigns also pave the way for hard paternalism, Mr Glaeser says. The recent wave of smoking bans rather proves his point.

The callow nephew

There are many ways for a government to queer the pitch in favour of one social result (more saving, less smoking) or another. In fact, as Messrs Thaler and Sunstein argue, governments often cannot remain neutral even if they want to. Something must serve as the default option, something must come top of the menu, and information, if it is to be provided at all, must be framed in one way or another. The soft paternalists want the government to use these tools knowingly, in favour of the outcome its citizens themselves would prefer if only they had the necessary discipline and discernment.

For its exponents, this is a paternalism for the times. People are jealous of their freedoms; yet

they squander them. They resent outside authorities telling them how to live their lives, but they lack self-command. They have legions of entrepreneurs dedicated to serving them better, but often they fail even to understand the embarrassment of offerings that is spread before them. Some gentle guidance would not go amiss.

But if such manipulation is sometimes a necessity, should it be made a virtue? Mill, for one, would have disapproved.

> He who lets the world choose...his plan of life for him, has no need of any other faculty than the ape-like one of imitation. He who chooses his plan for himself must...use observation to see, reasoning and judgment to foresee, activity to gather materials for decision, discrimination to decide, and when he has decided, firmness and self-control to hold to his deliberate decision.

Reasoning, judgment, discrimination and self-control—all of these the soft paternalists see as burdens the state can and should lighten. Mill, by contrast, saw them as opportunities for citizens to exercise their humanity. Soft paternalism may improve people's choices, rescuing them from their own worst tendencies, but it does nothing to improve those tendencies. The nephews of the avuncular state have no reason to grow up.

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Mergers and acquisitions

Once more unto the breach, dear clients, once more

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Takeovers are booming—with the usual hyperbole

WHITE knights, suitors, raiding parties, poison pills—the mergers and acquisitions (M&A) boom is in full swing, with all the usual swashbuckling imagery. This week alone, there was plenty of action. Alcatel and Lucent, two telecoms-equipment makers, ended five years of dallying with a €30 billion ($36 billion) Franco-American deal. General Motors offloaded 51% of its financing arm, General Motors Acceptance Corporation, to a consortium led by Cerberus, a distressed-debt fund turned private-equity firm. And Sir Richard Branson may net about £700m ($1.2 billion) in cash and shares from selling his stake in Virgin Mobile, a mobile-phone company, to NTL, a cable operator.

The pace of dealmaking in the first quarter of 2006 was feverish. Globally, the value of M&A averaged $10 billion a day, the highest for six years (in other words, since the height of the dotcom frenzy). This time, Europe accounted for more activity than America (see chart, below). According to Dealogic, a data provider, purchases of European companies added up to $418 billion, the most ever in a first quarter and more than twice as much as at the start of 2005. In America the total was $311 billion, up by 5% on a strong quarter last year.

Globally, the deals were big and brass-knuckled: led by AT&T's $67 billion acquisition of BellSouth, 14 were worth more than $10 billion; and many more bids were hostile than in the recent past. But in contrast to the last merger boom, deals were far more likely to be financed by cash than by shares. Two-thirds of all M&A in the quarter was cash only.

It is partly this use of cash that encourages bankers to claim, as they so often have in the past,

that this time is different—that these transactions will not end up destroying value for everyone (or almost everyone: the bankers themselves always seem to come out ahead). Cash, indeed, is abundant, debt is cheap and equity markets so far have applauded many mergers, so the bankers have half a point. But it is human, as much as financial, frailty that has undermined many deals in the past—and it may be only a matter of time before once again, fear and greed trip corporate chiefs into a new cycle of excess (see article).

For now, however, the financial underpinnings of the takeover boom appear more solid than at comparable times in the late 1980s and late 1990s. Companies in America and Europe have been through a long period of cost-cutting and balance-sheet repair since the dotcom boom ended. This has helped generate bumper profits and cash, which shareholders have decided they can trust companies to spend wisely—through either capital expenditure or acquisitions. "In the last 18 months, the equity markets have done a 180-degree flip," says Anthony Burgess, head of European M&A at Deutsche Bank. "They've become very positive about giving management the licence to do M&A."

By way of illustration, consider how stockmarkets have taken the rare step of rewarding predators for their bravery, as well as pushing up the share prices of their prey. Frank Yeary, global head of M&A at Citigroup, notes that the share prices of companies in the S&P 500 that have recently launched takeover bids worth $1 billion or more have outperformed the market in the 90 days after deals are announced. One reason for this unusual performance, he believes, is that takeover premiums have been modest. The difference between an offer price and the target company's previous share price is averaging around 20%, compared with 35-40% at past peaks of merger activity, he says. "It's a good environment to do deals."

Another reason for encouragement from shareholders is the cheap, plentiful debt that companies are, for the moment, able to use for deals, thereby lowering the cost of capital and increasing earnings per share. Although bankers are reluctant to say that there is a credit bubble, there are certainly signs of one.

For a start, it is easy to raise money even if the leverage cuts a borrower's credit rating. Credit quality is thus starting to slip. For example, Standard & Poor's, a rating agency, notes that the number of AA-rated (ie, very creditworthy) issuers has slid from 39 to 23 since 2001, while the number of much riskier BB credits has doubled.

Listed acquirers are having to dig deeper to compete against private-equity rivals flush with debt. Already, there are signs that the listed buyers are starting to gain the upper hand, as they should with the cost savings they can expect to make. According to Dealogic, the value of private-equity-backed M&A shrank to 14% of the total in the quarter just completed, compared with more than 25% in 2004.

Companies are being told that they have too little debt on their balance sheets. Last month analysts at Goldman Sachs estimated that European companies alone could draw upon €630 billion of funds, partly by raising their ratio of net debt to equity to the long-run average of 43%. That is equivalent to more than 8% of the value of Europe's stockmarkets.

Companies that might otherwise balk at taking on more debt are being told by silver-tongued

bankers that there are good reasons to do so. One such was Linde, the German chemicals company which made an agreed €11.6 billion takeover of Britain's BOC that will, if not blocked on antitrust grounds, create one of the world's top industrial-gas companies. The takeover will enable it to remove overlapping costs, and its increased size may also give it pricing power.

Bankers say such “horizontal integration” is a prime reason why dealmaking is busier in Europe than in America. In the United States, industries such as telecommunications and defence have already been consolidated and now contain only a few enormous companies. In Europe, only now is cross-border integration happening with the zeal that had been expected at the birth of the euro.

For the moment, the bulk of cross-border activity in Europe has been in utilities and energy, two industries that have raised the hackles of protectionist politicians, especially when the bidders come from abroad. In a few instances activist shareholders, too, have voiced opposition to transactions. VNU, a Dutch business-information group, is facing its second shareholder rebellion in less than six months.

But generally, as long as deals look as if they will create industrial powerhouses, cost synergies or pricing power, the markets are still supportive. They will stay that way until money gets tighter, profits ebb or managers lose their heads. The trouble is that, on past form, it wouldn't be surprising if all those things happened at once.

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General Electric

Learn as you churn

Apr 6th 2006
From The Economist print edition

An acknowledged master at takeovers

GENERAL ELECTRIC is a serial acquirer, a company that buys businesses almost like others buy raw materials. Its boss, Jeffrey Immelt, talks about building a “fast-growth portfolio”, one that is constantly changing but which currently embraces (among other things) financial services, plastics, health care and broadcasting. The word “electric” is slowly being replaced by plain “GE” in the company's literature; General Eclectic would be closer to the mark.

GE spends billions of dollars a year buying companies and has picked up a trick or two along the way. “It's a learning process,” says Pam Daley, the lawyer who heads GE's business-development team, responsible for all its acquisitions. “We try to be very expert in execution.”

About 230 people work full-time in the team—roughly a quarter of them at head office; the rest spread around GE's six main business units. Compare that with Procter & Gamble, a more traditional American manufacturer where the boss, A.G. Lafley, says that his business-development team consists of himself and his chief financial officer. P&G's biggest recent purchases (of Wella and Gillette) have resulted from unexpected phone calls from the aspiring targets.

The GE way is more systematic. Its expertise is gleaned from regular reviews that compare the performance of past acquisitions with the targets they were set. Monthly meetings chaired by Mr Immelt check that there is, as Ms Daley puts it, “a robust pipeline of future acquisitions”. No deal of more than $3m is done without Mr Immelt's approval.

Deals are judged on quantitative criteria (can they exceed the firm's hurdle rates of return?) and qualitative criteria (are they “on strategy”, aligned, that is, with the firm's plans for growth?). GE has learnt to start planning the detailed integration of its quarry earlier and earlier—even while it is still doing due diligence. Details count: a seemingly trivial issue with a product's warranty turned one recent deal into a near-disaster.

GE spends a lot of time looking for the reasons why deals fail. Unerasable from the corporate memory is the disaster of Kidder Peabody—a 1990s foray into the impermeable culture of investment banking. Jack Welch, the short, balding GE boss responsible for the deal, said later, “I didn't know a diddly about it. I was on a roll...I thought I was six-foot-four with hair.” Acquirers can learn few more important lessons than managers' propensity to overestimate their own ability.

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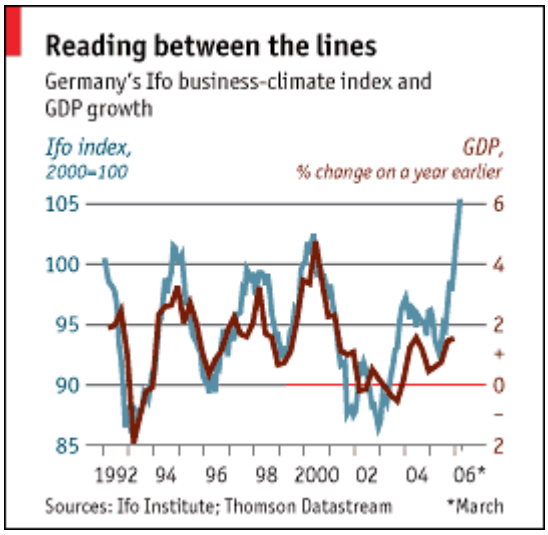
Business-confidence surveys

Leading us astray?

Apr 6th 2006
From The Economist print edition

The link between business confidence and GDP growth seems to have cracked



JUST as some people predict the weather according to the odd behaviour of birds or the leaves of tulips, so Germany's Ifo business-climate index, published each month by a Munich research institute, has long been the most closely watched leading indicator of the country's GDP growth. For the past couple of decades the two series have marched closely in step with one another—until this year, when a large gap seems to be opening up.

In March the index rose to its highest level since 1991 (see chart). Its average for the first three months of this year would, on past experience, signal year-on-year GDP growth of 5%, up from only 1% in the fourth quarter. Other official numbers, such as employment and retail sales, suggest that such heady growth is most unlikely. The consensus forecast for German GDP growth this year is less than 2%. Is the Ifo index losing its predictive power?

This question is also relevant in other European countries, where similar surveys have also tended to overstate GDP growth of late. Why are businessmen cheerier than their domestic economies warrant? One reason is that business surveys like Ifo's often give too much weight to manufacturing and too little to services, which have been growing much more sluggishly in Germany.

Another explanation, suggested by economists at Dresdner Kleinwort Wasserstein (DKW), is that the relationship between business confidence and GDP growth has been distorted by the drop in Germany's trend rate of growth. Based on the best fit between the two series in the 1990s, the Ifo index consistently understated growth in the 1970s and 1980s, when trend growth was much higher; today, with a lower trend, it overstates growth. But even after adjusting for the dwindling average, DKW reckons that the latest Ifo numbers still imply that German GDP will grow by an impressive 3.5%.

Perhaps the most compelling explanation of the widening gap between business surveys and official figures is offshoring. Exuberant business confidence may reflect companies' production and employment plans not at home, but in foreign plants in eastern Europe or China, where firms have shifted production to take advantage of lower labour costs. The Ifo index may thus tell us more about output and jobs in Budapest than in Berlin.

However, not all firms are moving out of Germany. A recent analysis by Credit Suisse shows that even if average unit labour costs in manufacturing are lower in eastern Europe, Germany still retains a comparative cost advantage in certain industries, including machinery and equipment, and metals. These industries have seen a much smaller flow of direct investment abroad than, say, cars and chemicals. So how optimistic are businesses in these sectors?

Interestingly, much of the rebound in the Ifo survey has been in industries that have mainly stayed put in Germany, thanks to their comparative advantage. For example, confidence among machinery and equipment makers has risen to an all-time high, while confidence in vehicle manufacture remains relatively weak. And the biggest improvement in any industry in the past year has been in retailing, which is firmly based at home. This suggests that while the Ifo index may somewhat exaggerate Germany's prospects, GDP growth this year could well spring a pleasant surprise.

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Citigroup and its regulators

A mixed week

Apr 6th 2006 | NEW YORK AND SYDNEY
From The Economist print edition

The giant bank's latest troubles could have wider ramifications

CITIGROUP has spent the past year in a sort of banking purgatory: after various lapses around the world, it was banned by American regulators from making large acquisitions until it put its internal controls in order. On April 3rd the bar was lifted. Scant comfort, perhaps. Not because, as its boss, Charles Prince, said, it hadn't made much difference anyway; nor because Citigroup had just been pipped in the race to buy a Turkish bank (see article); but because three days earlier the American giant had been accused by Australian regulators of insider trading.

It is the first time that Australia's financial regulator, the Australian Securities and Investments Commission (ASIC), has levelled this charge against an institution, rather than individuals. The significance of the case is much broader than the A$1m ($716,000) fine Citigroup could face if found guilty. It may call into question the whole model of big, complex investment banks housing both advisers and traders who bet firms' own money. Even with Chinese walls between the two operations, can regulators trust banks to manage the conflicts of interest that must arise?

The Australian regulator alleges that one of Citigroup's proprietary traders bought shares in Patrick Corporation, a transport company, while its bankers advised another company, Toll Holdings, in a A$4.6 billion takeover bid for Patrick. The trading occurred on August 19th 2005, three days before Toll's bid was announced to the stockmarket.

The trader in question, who is not a defendant in the case, had bought 1m Patrick shares worth more than A$5.75m on August 19th. Later in the day, he was told to stop buying. Soon afterwards, he sold 192,352 Patrick shares.

ASIC alleges that Citigroup profited from inside information and failed properly to manage a potential conflict of interest, a relatively new requirement under Australian law, even if there was no direct discussion about the impending bid. Citigroup denies the allegations and claims that it is a guinea pig in a test case.

“It is a lot about proving that the managing-conflicts strategy adopted [in Australia] has teeth,” says Dimity Kingsford Smith, a professor of law at the University of New South Wales. She notes that the regulator's decision to lodge a civil action, not criminal proceedings, gives it a higher chance of winning than many might think, because a lower standard of proof is required. ASIC declined to comment.

The accusation has caused uproar among investment banks. Many believe that regulators elsewhere might be encouraged to follow the course ASIC seems to be treading. Some argue that, if successful, the case will prevent banks from trading the shares of a company if they are also giving its management advice about a business deal, be it a takeover or any other transaction. They fear that regulators will no longer be satisfied with the internal rules that prohibit advisory

teams at a bank from giving traders confidential information. Further, anything that could be taken as a hint of a deal might be deemed inside information if the case is successful.

“It is one of the most significant pieces of litigation that ASIC has brought in many years. Most of its litigation never goes beyond an individual in terms of its implications. It usually doesn't establish new [case] law,” says Ian Ramsay, director of the Centre for Corporate Law at the University of Melbourne. This time, it could. Investment bankers everywhere might keep an eye on Australia.

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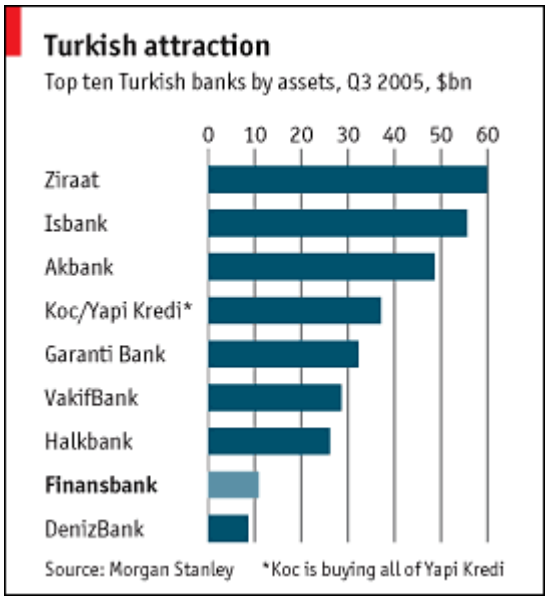
Banking in Turkey

Delightful

Apr 6th 2006 | ANKARA
From The Economist print edition

An unprecedented alliance between Greeks and Turks

IN THE past few months, some members of the European Union have done their best to warn foreigners off their corporate jewels—regardless of all that guff about the free movement of capital, single markets and so forth. Maybe its stuffier members could learn a thing or two from Turkey, a persistent knocker at the EU's door and one that some in the union would prefer never to let in. On April 3rd Finansbank, Turkey's eighth-biggest bank by assets and one of the country's best, was sold and not just to any foreigner, but to the National Bank of Greece (NBG).



Despite the remarkable growth in the two countries' bilateral trade in recent years, an investment like this is something of a breakthrough in an often fractious relationship. For those who like their history, the deal recalls the period a century ago when Greek bankers made fortunes as financiers to the Ottoman sultans.

With plenty of cash to spend, Greece's largest bank, which already has interests in other south-eastern European countries, has for months been looking at takeover targets in the region. “We want to become a true regional player,” says Takis Arapoglou, NBG's boss. The Turkish banking market is one of south-eastern Europe's most attractive. Last year GDP grew by 7% and it will probably do so again in 2006. Most of Turkey's 70m people are aged under 40. Add that retail banking is less developed in Turkey than it is farther west, and the potential for banks to make money from mortgages, credit cards and the rest seems clear.

That said, analysts think that NBG is paying a high price for its Turkish acquisition. It agreed to pay €2.3 billion ($2.8 billion) for 46% of Finansbank's shares and to make a public offer for a controlling stake, beating off America's mighty Citigroup in the final round of bidding. The purchase of Finansbank, says Mr Arapoglou, will immediately increase NBG's profitability by 10%. To those who think he has paid too much, he says: “The price is in line with what everyone else is paying in the region.”

Banks in the region have indeed been getting pricier. Big European banks in several countries have little room to grow at home and so have been chasing opportunities in eastern and south-eastern Europe. Almost all of them have looked at Turkey. In 2004 France's BNP Paribas and Fortis, a Dutch-Belgian bank, bought smallish institutions. Société Générale, also of France, is interested in state-owned Halk Bank, which is due to be privatised soon. Americans are entering the market, too: General Electric has bought a big stake in Garanti, the fifth-biggest bank;

Citigroup is said to be eyeing a stake in Akbank, the third-largest, having failed to land Finansbank.

Yet the Finansbank acquisition has special significance because of the two countries' history. This is the first purchase of a Turkish bank by a Greek bank and the biggest Greek investment in Turkey. Husnu Ozyegin, who founded Finansbank in 1987 and has created one of the region's most profitable banks, will remain in charge. His entire management team will also stay in place. This way, NBG hopes to reduce the danger that Finansbank's Turkish clients will defect to rivals.

Bankers on both sides of the deal have high hopes for the future of bilateral relations in business and finance. “This was a business-driven decision, but it could have a positive effect on politics,” says Mr Arapoglou. It certainly strengthens Turkey's image, in its talks about EU membership, as a modernising economy. If only every existing EU member could say the same.

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Chinese banks

Rot in the vaults

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Problems loom for China's newly refurbished banks

THE mainland's banks have never looked in better shape. On April 6th China Construction Bank, the country's third-largest lender, reported its results for 2005. Although net income dipped a bit, operating profit (a better reflection of its underlying business) rose by 17%, boosted by robust loan growth in a booming economy. The bank's shares have risen in price by more than half since it listed in Hong Kong last October, the first of the “Big Four” state banks to do so. Meanwhile, the share price of the smaller Bank of Communications (BoCom) has doubled since listing last year. No wonder that Industrial and Commercial Bank of China and Bank of China (BoC), another two of the Big Four, are as eager to sell shares this year as foreign investors are to buy them.

Reality, though, is less rosy than it appears. The banks look healthy largely because of repeated capital infusions, initially from the Chinese government but latterly also from foreign strategic partners and the capital markets. Moreover, the bad loans sluiced overboard in past bail-outs look as if they are being replaced by a new wave. China's rapid growth may be producing good-looking profits today, but it is storing up problems for tomorrow.

The biggest threat is overcapacity in almost every industry. Take steel, a big client of the state banks. China's rapacious demand drove steelmakers' profits from 5 billion yuan ($600m) in 1999 to more than 125 billion yuan last year. This triggered a surge of investment in new plants—worth 650 billion yuan in the past five years, two-thirds of it financed by the state banks. Today China has excess steelmaking capacity of 120m tonnes, or a third of its output. “No other country even produces 100m tonnes of steel—and that's China's excess,” marvels Nicholas Lardy, a senior fellow at the Institute for International Economics in Washington, who put the numbers together. The result is plunging returns. In the first two months of 2006, the steel industry's profits were 75% lower than a year before. On March 30th Baosteel, China's biggest producer, reported its first quarterly drop in net profits in more than three years. Stocks of steel are expanding and cashflow is drying up. Despite signs that global steel prices may be picking up, many steelmakers will find it hard to pay back the loans they took out to finance their expansion.

This overcapacity—and declining profits—is repeated in many industries, from power generation to cement, coke, aluminium, car parts and luxury property. All told, the banks face a fresh burst of bad loans, says Mr Lardy: “This could erase some of the very hard-won progress in bank reform in the last eight years.” The concerns go right to the top. At the annual meeting of China's parliament in March, Wen Jiabao, China's prime minister, pointed to a growing risk to the banks from a build-up of inventories.

Yet while the government has tried to curb investment in some industries, in others its foot remains firmly on the accelerator. It plans to splurge 2 trillion yuan on railways, including several new subway lines in Shanghai, in the next five years; to build 24,000 km (15,000 miles) of expressways by 2010; and to have 30 nuclear power stations by 2020, against nine now. Much of this will be financed by the banks, and not all with state guarantees. Dong Tao, chief Asia

economist at Credit Suisse, thinks a lot of it will not be commercially viable: “The returns will not be high. There will be a lot of new pressure on the banks.”

Nor can the banks rely on new consumer spending to bail them out. Although pundits have been hailing the emergence of the Chinese consumer for years, net new household borrowing declined in 2005, estimates Mr Lardy, and accounted for less than 15% of net bank lending. Last year, for the first time in nine years, the share of bank loans to households failed to grow.

These threats would be worrying enough if the banks had learnt how to lend properly. But they haven't. A new working paper by economists at the IMF finds that the big state banks still do not price their loans according to either the riskiness or the profitability of the borrower. An embarrassing tale last month of five officials at a remote branch of BoC, who embezzled 430m yuan, is further evidence that old, bad habits remain. Behind their newly burnished facades, China's banks still carry rot within.

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Emerging-market debt

Stylish haircut

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An unexpected bonus for investors in Argentina's debt

ARGENTINA'S $80 billion debt restructuring, completed in February 2005, looked like a catastrophe for investors in emerging markets. Bondholders had little choice but to accept the loss of two-thirds of their capital—a haircut, in the jargon, of unprecedented severity. The financial press was filled with fears that other borrowers struggling to service their debts might follow Argentina's example. Yet there was no wave of defaults. What might be copied, in fact, is a little-noticed component of the paper Argentina issued in its debt exchange that could do both lenders and borrowers some good, giving governments a less risky method of financing themselves and lenders a new source of higher yields.

In addition to payments of interest and principal, the new bonds contained a second potential income stream, called a GDP warrant. The prospectus envisaged a course for Argentina's economic growth rate over the life of the bonds, starting at 4.2% in 2005 and declining to 3% in 2015 and thereafter. In any year when the economy grows faster than expected, creditors will receive 5% of the difference between the size of GDP in that year and that predicted by the prospectus. The payments will continue until the bonds mature or the government has spent a total of $40 billion on the warrants, or 48% of the face value of the defaulted debt.

For some reason, the Argentine government laid little emphasis on the warrants in its roadshow to promote the restructuring. Investment banks found their worth difficult to assess. As a result, last year most analysts reckoned them to be worth practically nothing. But last November, as set out in the prospectus, the warrants were decoupled from the bonds and began to be traded independently on the secondary market. By then it was clear that in 2005 Argentina's GDP would grow by about 9% for the third straight year and that the peso would appreciate by 10% or so in real terms against the dollar (under the terms of the warrants, this also boosted the payout).

This not only meant that creditors were due to receive around $1.2 billion from the warrants, but also established a healthy gap between the economy's actual size and the path laid down in the prospectus. Because warrant holders are entitled to a percentage of this gap, even if Argentina exceeds its target growth rates by the merest fraction of a percentage point every year until the bonds mature, they can expect to receive similar payments annually. As it happens, economists have raised their forecasts for 2006 and 2007 and the payouts seem likely to increase. Because emerging markets continued to rally in 2005, lowering interest rates, the present value of those income streams increased even further.

Buried treasure

As a result, the warrants' price doubled in just four months, rising from 4.74 cents on the first day of trading to 9.4 cents last week. A recent report by analysts at HSBC bank suggests they have even more room to climb. Assuming that the Argentine economy grows by 7.5% in 2006, 5.7% in 2007 and an average of just over 3% subsequently, and that the still-undervalued peso strengthens against the dollar by 6.2% a year in real terms, they estimate that the dollar-denominated warrants are worth 15.7 cents apiece. And supposing that Argentina can somehow sustain growth comfortably above 3% in the long run—by no means certain, given the country's economic history—the warrants' value will soar yet again. The 48-cent ceiling would therefore be hit well before the new bonds mature.

The warrants' effect may not be limited to the unexpected relief they are providing for Argentina's aggrieved creditors. According to Walter Molano, an emerging-markets analyst at BCP Securities, the warrants' success may lead to a new class of variable-income securities, one with characteristics more similar to a share (where price and dividend payments are tied to future cashflows) than to a traditional bond (where payouts are fixed at the start). A market in such paper would enable governments to raise money without fear of default in a recession, because interest payments would decline or disappear when the economy was weak, and give creditors a windfall if growth was unexpectedly strong. Having cursed the Argentines only a year ago, moneylenders may yet find reason to thank them.

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Economics focus

Myths and migration

Apr 6th 2006
From The Economist print edition

Do immigrants really hurt American workers' wages?

Get article background

EVERY now and again America, a nation largely made up of immigrants and their descendants, is gripped by a furious political row over whether and how it should stem the flood of people wanting to enter the country. It is in the midst of just such a quarrel now. Congress is contemplating the erection of a wall along stretches of the Mexican border and a crackdown on illegal workers, as well as softer policies such as a guest-worker programme for illegal immigrants. Some of the arguments are plain silly. Immigration's defenders claim that foreigners come to do jobs that Americans won't—as if cities with few immigrants had no gardeners. Its opponents say that immigrants steal American jobs—succumbing to the fallacy that there are only a fixed number of jobs to go around.

One common argument, though not silly, is often overstated: that immigration pushes down American workers' wages, especially among high-school dropouts. It isn't hard to see why this might be. Over the past 25 years American incomes have become less equally distributed, typical wages have grown surprisingly slowly for such a healthy economy and the real wages of the least skilled have actually fallen. It is plausible that immigration is at least partly to blame, especially because recent arrivals have disproportionately poor skills. In the 2000 census immigrants made up 13% of America's pool of workers, but 28% of those without a high-school education and over half of those with eight years' schooling or less.

In fact, the relationship between immigration and wages is not clear-cut, even in theory. That is because wages depend on the supply of capital as well as labour. Alone, an influx of immigrants raises the supply of workers and hence reduces wages. But cheaper labour increases the potential return to employers of building new factories or opening new valet-parking companies. In so doing, they create extra demand for workers. Once capital has fully adjusted, the final impact on overall wages should be a wash, as long as the immigrants have not changed the productivity of the workforce as a whole.

However, even if wages do not change on average, immigration can still shift the relative pay of workers of different types. A large inflow of low-skilled people could push down the relative wages of low-skilled natives, assuming that they compete for the same jobs. On the other hand, if the immigrants had complementary skills, natives would be relatively better off. To gauge the full effect of immigration on wages, therefore, you need to know how quickly capital adjusts and how far the newcomers are substitutes for local workers.

City to city

Empirical evidence* is as inconclusive as the theory. One method is to compare wage trends in cities with lots of immigrants, such as Los Angeles, with those in places with only a few, such as Indianapolis. If immigration had a big effect on relative pay, you would expect this to be reflected in differences between cities' wage trends. David Card, of the University of California, Berkeley, is one of the leading advocates of this approach. His research suggests that although there are big differences between cities' proportions of immigrants, this has had no significant effect on unskilled workers' pay. Not everyone is convinced by Mr Card's technique. His critics argue that the geographical distribution of immigrants is not random. Perhaps low-skilled natives leave cities with lots of immigrants rather than compete with them for jobs, so that immigration indirectly pushes up the supply of low-skilled workers elsewhere (and pushes down their wages). Mr Card has tested the idea that immigration displaces low-skilled natives and found scant evidence that it does.

An alternative approach, pioneered by George Borjas, of Harvard University, is to tease out the effect of immigration from national wage statistics. Mr Borjas divides people into categories, according to their education and work experience. He assumes that workers of different types are not easily substitutable for each other, but that immigrants and natives within each category are. By comparing wage trends in categories with lots of immigrants against those in groups with only a few, he derives an estimate of immigration's effect. His headline conclusion is that, between 1980 and 2000, immigration caused average wages to be some 3% lower than they would otherwise have been. Wages for high-school drop-outs were dragged down by around 8%.

Immigration's critics therefore count Mr Borjas as an ally. But hold on. These figures take no account of the offsetting impact of extra investment. If the capital stock is assumed to adjust, Mr Borjas reports, overall wages are unaffected and the loss of wages for high-school drop-outs is cut to below 5%.

Gianmarco Ottaviano, of the University of Bologna, and Giovanni Peri, of the University of California, Davis, argue that Mr Borjas's findings should be adjusted further. They think that, even within the same skill category, immigrants and natives need not be perfect substitutes, pointing out that the two groups tend to end up in different jobs. Mexicans are found in gardening, housework and construction, while low-skilled natives dominate other occupations, such as logging. Taking this into account, the authors claim that between 1980 and 2000 immigration pushed down the wages of American high-school drop-outs by at most 0.4%.

None of these studies is decisive, but taken together they suggest that immigration, in the long run, has had only a small negative effect on the pay of America's least skilled and even that is arguable. If Congress wants to reduce wage inequality, building border walls is a bad way of going about it.

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* "The Labor Demand Curve Is Downward Sloping: Reexamining the Impact of Immigration on the Labor Market". George J. Borjas. *Quarterly Journal of Economics,* 2003

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Dark matter

Accidence and substance

Apr 6th 2006
From The Economist print edition

Two possible explanations for the bulk of reality

THE unknown pervades the universe. That which people can see, with the aid of various sorts of telescope, accounts for just 4% of the total mass. The rest, however, must exist. Without it, galaxies would not survive and the universe would not be gently expanding, as witnessed by astronomers. What exactly constitutes this dark matter and dark energy remains mysterious, but physicists have recently uncovered some more clues, about the former, at least.

One possible explanation for dark matter is a group of subatomic particles called neutrinos. These objects are so difficult to catch that a screen made of lead a light-year thick would stop only half the neutrinos beamed at it from getting through. Yet neutrinos are thought to be the most abundant particles in the universe. Some ten thousand trillion trillion—most of them produced by nuclear reactions in the sun—reach Earth every second. All but a handful pass straight through the planet as if it wasn't there.

According to the Standard Model, the most successful description of particle physics to date, neutrinos come in three varieties, called “flavours”. These are known as electron neutrinos, tau neutrinos and muon neutrinos. Again, according to the Standard Model, they are point-like, electrically neutral and massless. But in recent years, this view has been challenged, as physicists realised that neutrinos might have mass.

The first strong evidence came in 1998, when researchers at an experiment called SuperKamiokande, based at Kamioka, in Japan, showed that muon neutrinos produced by cosmic rays hitting the upper atmosphere had gone missing by the time they should have reached an

underground detector. SuperKamiokande's operators suspect that the missing muon neutrinos had changed flavour, becoming electron neutrinos or—more likely—tau neutrinos. Theory suggests that this process, called oscillation, can happen only if neutrinos have mass.

Since then, there have been other reports of oscillation. Results from the Sudbury Neutrino Observatory in Canada suggest that electron neutrinos produced by nuclear reactions in the sun change into either muon or tau neutrinos on their journey to Earth. Two other Japanese experiments, one conducted at Kamioka and one involving the KEK particle-accelerator laboratory in Tsukuba, near Tokyo, also hint at oscillation.

Last week, researchers working on the MINOS experiment at Fermilab, near Chicago, confirmed these results. Over the coming months and years, they hope to produce the most accurate measurements yet. The researchers created a beam of muon neutrinos by firing an intense stream of protons into a block of carbon. On the other side of the target sat a particle detector that monitored the number of muon neutrinos leaving the Fermilab site. The neutrinos then travelled 750km (450 miles) through the Earth to a detector in a former iron mine in Soudan, Minnesota.

By comparing how many muon neutrinos arrived there with the number generated, Fermilab's researchers were able to confirm that a significant number of muon neutrinos had disappeared—that is, they had changed flavour. Thus the neutrino does, indeed, have mass and a more accurate number can be put on it.

That number is tiny—0.00001% of the mass of an electron. But it is significant because neutrinos are so plentiful. While their mass is so small that neutrinos cannot be the sole constituent of dark matter, they have an advantage in that they are at least known to exist.

Darkness and light

The same cannot be said for sure of another possible form of dark matter being studied by a group of physicists in Italy. In a recent issue of *Physical Review Letters*, Emilio Zavattini and his colleagues at the National Institute of Nuclear Physics in Legnaro report an unusual signal in an experiment that goes by the unwieldy name of PVLAS. Like the good, sceptical scientists they are, the team has spent the past two years trying to explain the signal away—for example, as an artefact produced by the instruments. So far, however, they have failed. If the result continues to withstand scrutiny, it would appear to be evidence for an exotic new sort of fundamental particle, known as an axion, that could also be a type of dark matter.

The experiment itself is simple. The team sends a laser beam through a vacuum that sits in the centre of a powerful magnet. The laser light is polarised, meaning that it vibrates more in one direction than the other (for instance, from side-to-side rather than up-and-down). When the light emerges from the other side of the magnet, the team measures its polarisation to see what has happened.

According to the Standard Model, the answer should be very little, for the light has simply passed through empty space. Instead, Dr Zavattini and his colleagues found that the direction in which the emerging light vibrates is rotated ever so slightly from its original alignment. The effect is so small—and the measurement so precise—that a similar rotation in the minute hand of a clock would represent a billionth of a second.

Small though it is, this signal may be evidence for a brand new type of particle. Light itself is made up of particles called photons. The magnetic field in the experiment is composed of photons too, though unlike those of light, the photons of a magnetic field are continually flickering into and out of existence. If the signal Dr Zavattini has found is not an artefact, then its most likely

explanation is that photons from the laser are interacting with the photons of the magnetic field in a way that produces axions.

Life is never quite so simple, though. A particle with the properties that the PVLAS experiment may have observed contradicts several astrophysical experiments. Since axions can be produced from light, the sun and other stars should generate them copiously. Unfortunately, nobody has seen such particles directly. And several other experiments looking for dark-matter axions have failed to observe them.

To help resolve the issue, Raul Rabadan of the Institute for Advanced Study in Princeton and his colleagues propose, in the same issue of *Physical Review Letters*, an independent test that could begin as soon as the end of this year. They suggest shining a bright beam of X-rays through a magnet, into a thick wall of material that is opaque to X-rays, and then through another magnet. Since the wall is opaque, it should block the x-rays completely.

However, x-rays are high-energy photons, so if PVLAS is producing axions, some of these photons should also turn into axions along the way. Unlike photons, axions would pass directly through the wall to the other side. Once there, they could change back into detectable x-ray photons by the reverse of the process that generated them in the first place (hence the need for the second magnet). And, although such an experiment would not be cheap, it would not require a machine of Fermilab proportions to carry it out.

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Medicine

Tales of the unexpected

Apr 6th 2006
From The Economist print edition

Why a drug trial went so badly wrong

IN ANY sort of test, not least a drugs trial, one should expect the unexpected. Even so, on March 13th, six volunteers taking part in a small clinical trial of a treatment known as TGN1412 got far more than they bargained for. All ended up seriously ill, with multiple organ failure, soon after being injected with the drug at a special testing unit at Northwick Park Hospital in London, run by a company called Parexel. One man remains ill in hospital.

Small, preliminary trials of this sort are intended to find out whether a drug is toxic. Nevertheless, the mishap was so serious that Britain's Medicines and Healthcare products Regulatory Agency (MHRA), a government body, swiftly launched a full inquiry. On April 5th it announced its preliminary findings. These were that the trial was run correctly, doses of the drug were given as they were supposed to have been, and there was no contamination during manufacturing. In other words, it seems that despite extensive tests on animals and human-cell cultures, and despite the fact that the doses in the human trial were only a five-hundredth of those given to the animals, TGN1412 is toxic in people in a way that simply had not shown up.

This is a difficult result for the drug business because it raises questions about the right way of testing medicines of this kind. TGN1412 is unusual in that it is an antibody. Most drugs are what are known as “small molecules”. Antibodies are big, powerful proteins that are the workhorses of the immune system. A mere 20 of them have been approved for human therapy, or are in late-stage clinical trails, in America and Europe, but hundreds are in pre-clinical development, and will soon need to be tried out on people.

Most antibody drugs are designed to work in one of three ways: by recruiting parts of the immune system to kill cancer cells; by delivering a small-molecule drug or a radioactive atom specifically to a cancer; or by blocking unwanted immune responses. In that sense, TGN1412 was unusual because it worked in a fourth way. It is what is called a “superagonistic” antibody, designed to increase the numbers of a type of immune cell known as regulatory T-cells.

Reduced numbers, or impaired function, of regulatory T-cells has been implicated in a number of illnesses, such as type 1 diabetes, multiple sclerosis and rheumatoid arthritis. Boosting the pool of these antibodies seemed like a good treatment strategy. Unfortunately, that strategy fell disastrously to pieces and it will take a little longer to find out why.

The result highlights concerns raised in a paper just published by the Academy of Medical Sciences, a group of experts based in London. It says there are special risks associated with novel antibody therapies. For example, their chemical specificity means that they might not bind to their targets in humans as they do in other species.

The MHRA has decided that a working group of experts is now needed to decide how trials of this

sort of drug can be handled more safely. Its chief concern is how to test protein molecules that have new mechanisms, particularly if those molecules act on the immune system. While this expert group is working (it could take around three months) the MHRA will authorise further trials of compounds of this kind only after taking advice.

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Influenza

Just say “R”

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From The Economist print edition

Even a weak vaccine might be useful in an outbreak of influenza

A BRUTAL mathematics governs the spread of an infection. It is tied to what is known as the basic reproductive number, R_0. Whether the outbreak is of seasonal influenza, Ebola fever or bubonic plague, R_0 tells you, for each person infected, how many others are likely to be infected later. The higher R_0 is, therefore, the harder an infection is to control.

R_0 is one of the many things scientists don't know about the virus that will cause the next pandemic of influenza, because that virus has not yet emerged. This is a problem, because it makes it hard to plan to minimise the impact of that outbreak.

One solution is to produce a virtual world in which various types of virus can be modelled. This is the approach taken by a team led by Timothy Germann, of the Los Alamos National Laboratory in New Mexico, and his colleagues. In a paper published in the *Proceedings of the National Academy of Sciences*, Dr Germann and his team describe a “virtual” population of 281m people distributed across a virtual version of the United States in accordance with census data. They have made assumptions about how often people mix with each other, where they mix (schools, workplaces and homes), and how often and how far they travel. This virtual world allows them to look at viruses with different levels of infectivity, and at different strategies for tackling an outbreak: antiviral drugs, vaccines and restrictions on mobility such as closing schools and stopping people travelling.

One conclusion is that the use of antiviral drugs to stamp on outbreaks as they occur works only if R_0 is low and close contacts of those infected can be identified rapidly—something that needs advance planning. At an R_0 of 1.6, around 2.8m courses of antivirals are needed; at an R_0 of 1.7, 10m courses are needed; at an R_0 of 1.8 a whopping 51m courses are needed. If all goes well, America should have 20m courses stockpiled by the end of the year. However, during any such mass treatment, the virus would be likely to evolve resistance to the drug, and the effect of this is unknown.

As R_0 increases from 1.6 to 1.9, the model predicts that an outbreak of influenza will change from one that can be controlled with moderate effort to one that needs several strategies applied vigorously. If R_0 exceeds 1.9, the authorities must be prepared to enforce a combination of behavioural changes, such as school closures and travel restrictions, and distribute antiviral drugs and the best available vaccine.

The most unexpected finding of the study, however, is how useful even a weakly effective vaccine could be. At any value of R_0 that is less than 1.9 such a vaccine, if widely deployed, could

markedly slow the progress of the disease and limit the number of sick people to less than 10% of the population. This means that useful vaccines might be produced in anticipation of an epidemic, simply by guessing which strain might eventually emerge. As long as the guess was approximately right, the resulting vaccine would confer enough protection to break the chain of transmission. Also, Dr Germann's paper suggests that even when two doses of a vaccine are needed to give an individual full protection, it is more efficient, from the point of view of stopping the epidemic, to vaccinate twice the number of people with a single dose.

These results emphasise the importance of today's research into human vaccines for H5N1, the most threatening strain of lethal bird influenza. Unfortunately, a vaccine trial in America last week gave only disappointing results, with an immune response in less than half of the people given two huge doses of antigen—the active ingredient in a vaccine. However, many other vaccines are in development, and GlaxoSmithKline, a big drug company, says that it is testing ways of using small doses of bird-flu vaccines in which the potency has been boosted by the addition of a chemical adjuvant. There may not yet be a way to stop a pandemic, but people are certainly looking hard.

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Palaeontology

A fish out of water

Apr 6th 2006
From The Economist print edition

A newly discovered step on evolution's journey

IN AN age of computer animation so good that prehistoric creatures can be made the subject of realistic-looking wildlife documentaries, the attractions of the crumbling fossils on which those animations are based are much diminished. But old bones can still throw up a surprise or two. And a paper in this week's *Nature* contains, if not exactly a surprise, then at least a gratifying confirmation of something long predicted—one of the missing links between fish and amphibians, and thus a direct, if distant, ancestor of humanity.

Tiktaalik roseae was found on Ellesmere Island in the Canadian Arctic by a team led by Edward Daeschler of the Academy of Natural Sciences in Philadelphia. This skeleton, and several others, were dug from rock formed 383m years ago during a period known to geologists as the Devonian. Anatomically, *Tiktaalik* falls neatly between *Panderichthys*, a species from 385m years ago that is clearly a fish, and *Acanthostega*, from 365m years ago, a species that is regarded as an early amphibian. Its halfway-house status is given away by the fact that its body scales and lower jaw are fishlike, while its skull, ear and neck are like those of an amphibian. It also has a wrist joint—but no digits—on limbs that might be viewed, according to taste, either as pectoral fins or as forelegs.

Why fish developed legs is a matter of debate. One theory, proposed by Jennifer Clack, of Cambridge University, is that legs' first use was to help their owners lift their heads out of the water to breathe air. Hence the importance of the wrist joint. Only when air-breathing had become routine was it worthwhile evolving legs strong enough to stand on dry land. But that is still speculation. Yet more fossils are needed to confirm it.

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Latin America

Brazil for beginners

Apr 6th 2006
From The Economist print edition

Fernando Henrique Cardoso's memoirs of his two-term presidency of Brazil are fascinating. What a shame that the English version of his life is so thin

The Accidental President of Brazil: A Memoir
By Fernando Henrique Cardoso and Brian Winter

PublicAffairs; 291 pages; $26.95. Published in Brazil as "A Arte da Política: A História que Vivi"; Civilizaçao Brasileira; 699 pages; 70 reais

Buy it at
Amazon.com
Amazon.co.uk

Reuters

IN MAY 1993 Fernando Henrique Cardoso was Brazil's foreign minister. He was at a dinner party in New York when he received a call from Itamar Franco, the eccentric interim president, who said he was thinking of making Mr Cardoso finance minister. The job was a poisoned chalice. Inflation would top 2,500% that year and Mr Franco had already been through three finance ministers in seven months. Mr Cardoso recounts in this memoir that when he went to bed he believed he had persuaded the president to think again.

Mr Franco appointed him regardless. It was that “accident” that led to Mr Cardoso, a brilliant but vain sociologist who lacked the common touch, being twice elected president of Brazil. As finance minister, he steered through the Real Plan, a clever mix of budget cuts, a new currency and a mechanism to break entrenched inflationary expectations. It worked. Grateful Brazilians gave him the top job.

As president for eight years, Mr Cardoso waged endless political battles to modernise the Brazilian state in the teeth of opposition from special interests. His great achievement was to bring political and economic stability and some social reforms to a country which had rarely enjoyed any. But this book devotes only three of its 12 chapters to his presidency. Rather, it is “mostly a book about [the] people” he met during a life spent close to the centre of his country's recent history.

Mr Cardoso was born into an upper-middle-class military family. His grandfather played a prominent part in a military conspiracy which overthrew Brazil's last emperor and ushered in the republic in 1889. His father, also a general, was part of the influential *tenente* movement of young radical military officers in the 1920s. The family business was politics as much as soldiering. But Mr Cardoso chose to become an academic. As a young sociologist, he investigated his country's searing social injustices and found himself interpreting for Jean-Paul Sartre when the French philosopher visited Brazil in 1960.

After a military coup in 1964, he was seen as a “subversive” and spent four years in exile in Chile. He was a visiting professor at the Nanterre campus of the University of Paris when the 1968 *évènements* erupted; Daniel Cohn-Bendit was one of his students. He returned to Brazil just as the military regime became more repressive. When the government sacked him from his post as a professor at the University of São Paulo, he set up a pioneering think-tank to stimulate civic resistance to the regime and to fight for democracy. That fight took him eventually into politics. One of Mr Cardoso's early allies was Luiz Inácio Lula da Silva, a young trade-union leader. His much-strained friendship with Lula, the leftist whom he twice defeated in presidential elections but who succeeded him, is one thread running through the book. He admits to being hurt by Lula's criticism of him as a “neo-liberal”, and vindicated when Lula followed the same broad policies that

he had put in place.

Mr Cardoso, a social democrat, says that throughout his political career, “I have always focused on the best way possible to reach an ideal goal.” That led him to conclude that Brazil must embrace capitalism and globalisation, and caused him to be attacked by both left and right. His claim to theoretical consistency is less plausible. Shortly before he took office, a Brazilian newspaper famously quoted him as saying: “forget everything I wrote in the past. The world has changed.” He says this quote was invented by the newspaper.

Yet he does appear guilty of reinterpreting some of his past writings to fit his later views. In Chile he co-wrote a book that became a bible of dependency theory, the hugely influential but mistaken notion that Latin America's underdevelopment was a product of its subordinate status in the world economy. Here he insists his argument was that the region in fact had control over its own destiny, even if others interpreted the book as saying the opposite. Mr Cardoso seems nearer the mark when he says that “methodology, rather than ideology, was the true legacy” of his academic career. In the presidency, he remained “a sociologist at heart”, trying to assemble information and opinions before taking decisions.

Hope followed by disappointment is a peculiarly Brazilian condition, Mr Cardoso notes. Even so, it is safe to assume that Brazil, the world's fourth-largest democracy, will also become one of the world's biggest economies in the coming decades. Yet it is a country of which Americans are profoundly ignorant. Mr Cardoso quotes George Bush as asking him: “Do you have blacks in Brazil?”

It is hard to think of a better-qualified guide to his country, and to the broader challenge of making democracy work in Latin America, than Mr Cardoso. So it is regrettable that his American publishers opted not to translate, albeit in abridged and edited form, the fuller Portuguese-language version of his memoir, published last month in Brazil. In this book, Mr Cardoso offers a more detailed narrative, interspersed with professorial meditations, on the great battles of his presidency to preserve economic stability in the face of global financial crises and to create a modern democratic state. He was not always successful. His conclusion that “it is not by chance that reforms are so difficult” will find an echo with many European politicians at the moment.

Instead, PublicAffairs hired Brian Winter, a former Reuters journalist, with the task of helping Mr Cardoso produce a book aimed at Americans. Between them, they have produced a stimulating and enjoyable read. But it is an unsatisfactory arrangement. The reader is unsure how many of these words are Mr Cardoso's and is left wanting much more, especially on his years in power. He was, after all, one of the most impressive Latin American presidents of his time, or indeed of any time. As the region toys with regressive populism, his voice is an important one.

The Accidental President of Brazil: A Memoir.
By Fernando Henrique Cardoso with Brian Winter.
PublicAffairs; 291 pages; $26.95.

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New fiction

Neither here nor there

Apr 6th 2006
From The Economist print edition

DAVID MITCHELL'S pyrotechnic fancy, “Cloud Atlas”, came within a whisker of winning the Man Booker prize in 2004, and was one of the year's most popular sellers. Fans of that book may be disappointed then that his latest offering is traditionally plotted in chronological order from a single, first-person point of view. Nevertheless, a more standard structure is a good test of Mr Mitchell's literary prowess, one that puts the distracting spirals of complex temporal leaps and multiple story lines deliberately out of reach.

Black Swan Green
By David Mitchell

Random House; 304 pages; $23.95.
To be published in Britain by Sceptre on May 11th

Buy it at
Amazon.com
Amazon.co.uk

Mr Mitchell's facility proves as agile as ever. He is an able mimic, and easily assumes the voice of a 13-year-old from Worcestershire. But the results are quotidian. Optimistically one might deem “Black Swan Green” a “classic” coming-of-age tale, but a more stringent adjective would be “routine”.

Black Swan Green is cast as Nowheresville, a hinterland that—the standing village joke—doesn't even have any swans. A “middle-ranking” kid ever in danger of sliding down into the social dregs, the adolescent protagonist Jason Taylor is relentlessly bullied for his stammer. His flair for writing poetry—which he is obliged to keep secret from his tormentors, lest he seem “gay”—is a transparent stand-in for the author' s own budding literary gifts in Worcestershire, where Mr Mitchell grew up.

Yet this is no “Portrait of the Artist as a Young Man”. Nor is it even “Paddy Clark Ha-Ha-Ha”, which “Black Swan Green” more resembles. Just as in Roddy Doyle's distinguished Booker winner, the reader is more keenly aware than the young narrator that his parents' marriage is in a state of perhaps terminal decline. But even this thread does not spare the novel a droning, episodic quality. Likewise the Falklands war and village indignation at the arrival of a group of travellers seem merely beads in a string, and fail to provide the book with momentum or overarching shape.

“Black Swan Green” is competent, and sometimes entertaining. But it is also ordinary, and no amount of able transcription of the local vernacular reprieves the novel's stock discoveries about sex or yearning speculations about the future from sounding all too painfully familiar.

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By David Mitchell.
Random House; 304 pages; $23.95.
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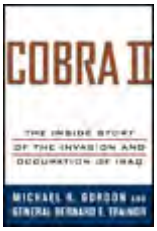
War in Iraq

Led by donkeys

Apr 6th 2006
From The Economist print edition

AMERICAN taxpayers have paid for hundreds of journalists to be embedded among United States forces in Iraq. Not all have justified the expenditure. “Embedded” reports tend to offer big conclusions about the war based on a snapshot of evidence. That is emphatically not true of this magisterial history by Michael Gordon, the military correspondent of the *New York Times*, who was given unparalleled access to America's top commanders as they prosecuted the war, and Bernard Trainor, a retired marine general. With mountains of fresh detail on the war's planning and progress, and judicious analysis, “Cobra II”, named after the invasion's code-name, will be hard to improve upon.

Cobra II: The Inside Story of the Invasion and Occupation of Iraq
By Michael Gordon and Bernard Trainor



Pantheon; 603 pages; $27.95.
Atlantic Books; £25

Buy it at
Amazon.com
Amazon.co.uk

The authors also argue that America's bad policies have turned the occupation of Iraq into a fiasco—a fiasco that was not inevitable. They give George Bush's national security chiefs a pasting. The best, such as Condoleezza Rice, the national security adviser, were feeble; the worst vain and incompetent—and the worst of all were Donald Rumsfeld, the defence secretary, and General Tommy Franks, who commanded the invading troops.

For 18 months beforehand, Mr Rumsfeld bullied his officers into writing war-plans bound by his dogmas. With utter faith in the technological superiority of America's troops, and a profound ignorance of Iraq, he saw to it that America invaded the country with around one-third of the soldiers that many of his generals wanted. Those who questioned the tactic were chased sneeringly away.

A visceral aversion to protracted peacekeeping led Mr Rumsfeld to want to withdraw most of these troops within a few weeks of occupying Iraq. Such a move would only be possible if the country's institutions, including the army and police, survived the invasion intact, which Mr Rumsfeld, of course, predicted that they would. He also assumed that allies would send peacekeepers to help out. Some military planners urged a more cautious approach; one wise man suggested preparing a force of American policemen in case Iraq's police collapsed. They were ignored.

General Franks proved the defence secretary's perfect ally. Oafish and proud of it, the general was only interested in grabbing Iraq, not in rebuilding it. This was unfortunate as Mr Rumsfeld had volunteered his department for that task—in part, it appears, to spite Colin Powell at the State Department. A month before the invasion, America still had no post-war plan.

On the battlefield, of course, America scored crushing victories. Yet the nature of the opposition it encountered—completely unlike what the Central Intelligence Agency (CIA) had predicted—should have raised alarms. The first American serviceman killed in combat was shot by a man dressed in

civilian clothes riding in a civilian car—and so it continued. Saddam Hussein's much talked-up Republican Guard units melted away; the war featured no big battle between regular forces. But in many towns where the CIA had predicted that American troops would find cheering crowds—and even suggested distributing American flags for them to wave—they encountered bitter resistance from irregular, often suicidal, fighters. Many of these were members of pro-Saddam militias raised to fight Iraq's rebellious Shia. Some were foreign Islamist fanatics. Across southern and central Iraq, Saddam had built them thousands of armouries—many of which, no doubt, they are drawing upon still.

Without good battlefield intelligence, the Americans were unable to capitalise fully on their gross technological advantage. Their victories often owed more to traditional soldiering skills, with brave infantrymen shooting and moving under fire. Messrs Gordon and Trainor describe almost every significant firefight of the campaign. Casual readers may forgive themselves for skimming the odd clash.

Despite its title, the book says little, and almost nothing new, about America's shambolic occupation. As American troops took Baghdad, Mr Rumsfeld initially cancelled plans to send even the paltry reinforcements envisioned in the war-plan. That left only 1,200 all-important infantrymen to patrol a city of 6m; and a single cavalry squadron in western Iraq, which includes the rough town of Fallujah. America's allies sent few reinforcements. As the Iraqi state and the security forces collapsed, the Americans could only watch the mayhem around them.

How much America has learned from the disaster, only history will show. In the short term, the signs are hopeful. Several of those who emerge favourably from this account are now in senior positions: General John Abizaid, for example, who had predicted that American troops would be considered an “antibody” in the Arab world, has General Franks's job; and Zalmay Khalilzad, a shrewd diplomat, once side-lined by the defence secretary, is now America's ambassador in Baghdad. But America has not admitted its grave faults in Iraq, or made an example of any of those most responsible. “Cobra II” makes very clear that, at the very least, Mr Rumsfeld's head should have rolled.

Cobra II: The Inside Story of the Invasion and Occupation of Iraq.
By Michael Gordon and Bernard Trainor.
Pantheon; 603 pages; $27.95.
Atlantic Books; £25

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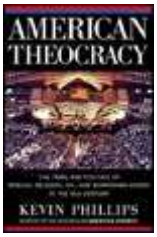
Religion and politics

Internal combustion

Apr 6th 2006
From The Economist print edition

TOM WOLFE once delivered the perfect retort to Günter Grass's portentous warning that "the dark night of fascism is falling on America". Mr Wolfe asked: "Why is it that the 'dark night of fascism' is always falling on the United States—and always landing on Europe?" You only have to substitute the words "theocracy" for "fascism" and "the Middle East" for "Europe" to question the logic of Kevin Phillips's latest opus.

American Theocracy: The Peril and Politics of Radical Religion, Oil, and Borrowed Money in the 21st Century
By Kevin Phillips



Viking; 448 pages; $26.95

Buy it at
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The Middle East is full of theocrats who debate such niceties as whether homosexuals should be stoned or crushed to death, or whether schools should devote all their time to teaching the Koran or just most of it. And in America? Prayers are banned in schools. Anti-gay prejudice is frowned on. Women make up more than half the students at universities. Freedom of speech and the separation of church and state are guaranteed by the constitution.

Mr Phillips is one of the most talented political analysts in America: a man who achieved national fame in 1969 when he heralded "The Emerging Republican Majority", but who has lately morphed into a fierce critic of the Bush administration. He displays characteristic learning and verve when he argues that America is turning into a theocracy. Look at the growing religious divide between Republican voters and Democratic voters, he points out: fully 78% of evangelical Protestants and 85% of orthodox Jews voted Republican in 2004. Or look at the party machinery. The churches now provide the GOP with its get-out-the-vote infrastructure, and right-wing theologians provide it with its ideas. In 2004 the seven highest officeholders in the Senate received 100% ratings from the Christian Coalition.

Mr Phillips paints a chilling picture of American religion as a mixture of biblical literalism and Southern-fried bigotry. American Christians are fiercely opposed to science and women's rights, he argues, and equally fiercely convinced of America's duty to save the world. They confidently expect the biblical apocalypse to come at any moment. They regard the turmoil in the Middle East not as a mess to be avoided but as proof that God's will is being worked out.

And yet it is hard to read all this without Mr Wolfe's common sense breaking through. How plausible is Mr Phillips's portrait of American Christians as fellow travellers with the Taliban? A great deal of American Christianity has more to do with making the best of this world than with the end of times (Tim LaHaye, who Mr Phillips excoriates as the author of the "Left Behind" series, also once wrote a Christian version of the "Joy of Sex"). And how influential is the so-called religious right? It is only one part of the Republican coalition, though admittedly an important one. Yet 38% of people who support abortion rights and 22% of people who also support gay marriage voted for George Bush in 2004. Much of the religious right's energy is spent on preventing the further advance of liberalism, most notably through gay marriage, rather than in promoting

theocracy. And America's constitutional defences against theocracy are remarkably strong—as anyone who tries to organise a prayer meeting in their local public school will soon discover.

American Theocracy: The Peril and Politics of Radical Religion, Oil, and Borrowed Money in the 21st Century.
By Kevin Phillips.
Viking; 448 pages; $26.95

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Design

Brave new worlds

Apr 6th 2006
From The Economist print edition

A dynamic new exhibition shows how Modernism drove the 20th century

V and A Museum

Furniture fashion

MODERNISM set out to turn dreams of the future into reality—and for a brief period between the wars it nearly succeeded. “Modernism is above all a search for Utopia,” says Christopher Wilk of the Victoria & Albert Museum, the curator of a new travelling show of designs for kitchens and cars, houses and health spas that were all part of the movement to rebuild a war-ravaged world.

Designers saw themselves as part of a grand collective enterprise to build a new society. Urban housing shortages between the wars made building a social priority in Europe. Walter Gropius, a German architect, established the Bauhaus as an interdisciplinary school of art and design, which sought to create bright, new living spaces. He also advocated pre-fabricated housing for the masses.

This spirit spread across Europe, from the utopia of revolutionary Russia as envisioned by artists

such as Aleksandr Rodchenko, to the city planning of Le Corbusier in France and the more spiritual abstraction of Gerrit Rietveld and the Dutch De Stijl movement. Less well-known, though just as vigorous, is Czech Modernism-represented here by the Tatra limousine and other classic designs that were part of the newly independent nation's embrace of the modern world.

Despite the diversity of political beliefs across Europe at the time, America provided the universal beacon. European designers of every persuasion adopted mass production as espoused by Henry Ford. And in the 1920s, leading architects such as Gropius made a grand tour from Dearborn, Michigan, to Chicago and New York to see the machine age in action and bring its energy home.

The most surprising and resonant part of this exhibition shows how healthy living became a key tenet of Modernism. Designers looked afresh at the human body and sought to turn it into a healthy machine. Architects believed that sunlight, fresh air and uncluttered living spaces would banish the contagions of tuberculosis and flu. This led to new designs for housing, clinics and sanitoria, all featuring flat roofs, balconies and industrially produced plates of clear glass to let in light. Women, in particular, started taking dance and exercise classes, and Rudolf von Laban pioneered modern dance techniques. The exhibition shows all this through a wonderful array of carefully selected objects: a wool bathing suit by Sonia Delaunay, clever use of archival footage and the world's first mass-produced fitted kitchen, the Frankfurt Kitchen of 1927, which was emblematic of the new vitality. Its ingenious built-in cabinets kept workspaces clear, promoting hygiene in the home. It was installed in thousands of Frankfurt flats and would be welcome in any small apartment today.

However, the Nazis, who came to power in 1933, disapproved of the Bauhaus's avant-garde ideals and immediately closed it down. By the mid-1930s, a generation of designers had fled to Britain, a country that until then had remained aloof from Modernism. One striking element of this show is what Mr Wilk calls Britain's "schizophrenic attitude" to Modernism. On the one hand, it mistrusted the cosmopolitan, urban and ideological tendencies of Modernism, yet it provided a safe haven for its presiding geniuses. Architects such as Bertold Lubetkin and Erno Goldfinger, and graphic designers such as Stephan Lorant (who designed *Picture Post* magazine) and Hans Schleger (designer of the bus stop sign), took refuge in Britain and helped reshape their host country.

Despite this, Modernism in Britain still seems to fit like a square peg in a round hole. Mr Wilk hopes this demonstration of its finest achievements in design will change attitudes and remind viewers that modernist designers' dreams of improving the world are just as important today. At a time when both the British Chancellor of the Exchequer and the Californian founders of Google flaunt their Prius hybrid cars as models of planet-saving purity, surely the power of design as an icon and agent of change is as potent now as it ever was?

"Modernism: Designing a New World, 1914-1939" is at the Victoria & Albert Museum in London until July 23rd and at the MARTa Herford in Germany from September 16th-January 7th 2007, and afterwards at the Corcoran Gallery of Art, Washington, DC.

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Worldwide bestsellers: travel books

The big book index

Apr 6th 2006
From The Economist print edition

Pick book, book and pack

ONE of the joys of reading travel books is that you don't need to leave home to experience exotic faraway places. The spice-scented kasbahs of Morocco, the backstreets of Italy, all the marvels that are to be enjoyed between Maui and Madrid or India and Indonesia—even the wonderful world of Walt Disney: they are all there between the covers of the ten biggest-selling travel books. Which is one reason why armchair travel was invented.

1. Eat, Pray, Love: One Woman's Search for Everything Across Italy, India and Indonesia.
By Elizabeth Gilbert. Viking; 352 pages; $14.97. Bloomsbury; £6.59

Woman in her 30s, who crashes into the buffers, then embarks on a life-changing trip only to find happiness in a place she could never have imagined. A funny, tender and thoughtful book.

Click to buy from Amazon.com or Amazon.co.uk

2. The Unofficial Guide to Walt Disney World 2006.
By Bob Sehlinger and Len Testa. Wiley; 832 pages; $12.34 and £8.57

Where to stay and what to eat is fine, as advice goes. But how to spare yourself from queuing for four hours on end is where this book really comes into its own.

Click to buy from Amazon.com or Amazon.co.uk

3. Birnbaum's Walt Disney World 2006.
By Birnbaum. Disney Editions; 272 pages; $11.02 and £7.91

Every ride and restaurant in Walt's world—and tips on how to stick to the budget.

Click to buy from Amazon.com or Amazon.co.uk

4. 1,000 Places To See Before You Die. By Patricia Schultz. Workman; 800 pages; $12.32 and £8.57

Address-book heaven—e-mail, phone and fax numbers for 1,000 must-see places.

Click to buy from Amazon.com or Amazon.co.uk

5. Unforgettable Journeys to Take Before You Die.
By Steve Watkins and Clare Jones. Firefly Books; 256 pages; $12.97. BBC Books; £11.38

Two veteran travellers offer details of 30 of their favourite unexplored locations.

Click to buy from Amazon.com or Amazon.co.uk

6. A Year in the World: Journeys by a Passionate Traveller.
By Frances Mayes. Broadway; 448 pages; $15.60. Bantam Press; £8.99

From the backstreets of Fez to the food markets of southern Italy; just the smell tells you that lunch is coming.

Click to buy from Amazon.com or Amazon.co.uk

7. Rick Steves' Italy 2006. By Rick Steves. Avalon Travel Publishing; 656 pages; $12.97

Hugely popular and opinionated advice on how really to feel part of an Italian neighbourhood.

Click to buy from Amazon.com or Amazon.co.uk

8. Ghosts of Spain: Travels Through a Country's Hidden Past.
By Giles Tremlett. Faber and Faber; 436 pages; £10.19

The Economist's Madrid correspondent asks why Spaniards are the world's most frequent visitors to plastic surgeons.

Click to buy from Amazon.co.uk

9. Maui Revealed: The Ultimate Guidebook. By Andrew Doughty. Wizard Publications; 312 pages; $10.37 and £8.24

Local Maui residents reveal everything about what to do and where to go. You couldn't ask for better guides.

Click to buy from Amazon.com or Amazon.co.uk

10. The City of Falling Angels.
By John Berendt. Penguin Press; 432 pages; $16.35. Sceptre; £11.99

The author of "Midnight in the Garden of Good and Evil" tries the trick again among the flash folk of Venice.

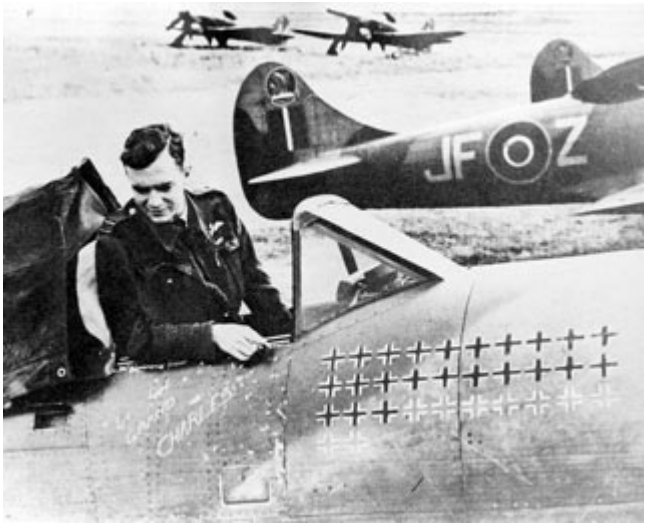
Click to buy from Amazon.com or Amazon.co.uk

Source: Global sales from Amazon.com, Amazon.co.uk, Amazon.ca, Amazon.de, Amazon.fr, Amazon.jp from March 1st-30th. Prices quoted from Amazon.com and Amazon.co.uk are correct as of April 3rd.

Pierre Clostermann

Apr 6th 2006
From The Economist print edition

Pierre Clostermann, a French fighter pilot, died on March 22nd, aged 85



IN JULY 1940, a somewhat-surprised, Brazilian-born student at the aeronautical department of the California Institute of Technology received a letter from his father, asking him to take charge of his mother and dispatch her to Brazzaville in central Africa, where she would apparently be safe. For his part, the boy's father was heading for London to join a certain Charles de Gaulle, a little-known member of the French cabinet who had by good fortune found himself in London when his government collapsed. Why didn't the boy come too?

On June 18th, just before France surrendered to the Germans and Italians, this General de Gaulle had made an impassioned broadcast on the BBC to ask his compatriots in the armed services to join the fight against the Nazis. In the event, only about 7,000 volunteers made their way to Britain, and it would be 1941 before Pierre Clostermann joined them. But join them he did. Rereading his father's letter on the beach in Malibu, he had been unable to resist the pull of what promised to be an adventure. He had read about Britain's Royal Air Force. Now he would be the pilot not of a Dewoitine 520, the French fighter of which he had dreamt, but of a Spitfire. “My decision was taken.”

Clostermann *père* was a diplomat: his posting to Rio de Janeiro accounted for Pierre's Brazilian birth. Before that, though, he had fought in the first world war, returning home with wounds, medals and glory in equal measure. The family came from Alsace-Lorraine, where warfare was habitual and sons were always expected to fight. Yet this was not a glorious moment for France. The surrender was followed by the setting up of a puppet regime in Vichy and a period of collaboration with the German occupiers that was to haunt Frenchmen for half a century. Officially, it was not so bad. The more shameful episodes of 1940-45 were not discussed, and in international councils post-war France was treated as a victor. But everyone knew that, actually, it

had, er, come second.

For all that, France also had genuine war heroes, and Mr Clostermann was undoubtedly one of them. No one is quite sure how many enemy aircraft he really shot down. At one time the number was put as high as 33, but that was certainly an exaggeration, even after the German aircraft he destroyed on the ground had been subtracted. Nonetheless, “Clo-Clo” could lay claim to at least 18 kills, and was credited by his British colleagues with bountiful supplies of both skill and courage.

He started out flying Spitfires with the Free French fighter squadron “Alsace”, based first in Scotland and then at Biggin Hill, south-east of London. Before long, he had his first success: not one, but two Focke-Wulfs in a single encounter over the Channel. “I climbed steeply, did a half roll and, before they could complete the 180° of their turn, there I was...behind the second one. A slight pressure on the rudder and I had him in my sights... Quickly I squeezed the firing button. My first burst had struck home and no mistake.”

Jolly good show

That account comes from “The Big Show”, the English version of Mr Clostermann's story of his exploits, published in 1948 in France as “Le Grand Cirque” and still selling well in many languages. It is a classic of its kind, both gripping and ripping, full of action, walk-on parts for semi-clad Windmill Girls and liberal use of the lingo of the day (“Out of the corner of my eye I saw Martell settling the hash of a second Jerry, whose tail-plane floated off... I was still so excited and overwrought that I nearly pranged on landing”).

In due course, Mr Clostermann was posted to an RAF squadron and soon found himself involved in bomber escorts, intercepting enemy aircraft high over Britain's naval base at Scapa Flow or attacking V-1 launch sites in France. There were some “unsavoury incidents”, such as the one in 1944 in which an entire formation of American Fortresses dropped their bombs not on their target, a marshalling yard in the French town of Rouen, but in a carpet of explosions on the local civilians nearby. This nearly had Clo-Clo shooting at his allies. Another incident, though, he made less of. That was his failure, the year before, to give cover to his squadron leader, René Mouchotte, in an engagement in which the revered French airman had been shot down and then drowned.

On June 11th 1944, four years after the fall of France, Mr Clostermann was one of the first French pilots to land—in a cloud of dust—on French soil. The derring-do continued, despite a leg wound caused by anti-aircraft fire the following March and a lucky escape soon after when he had to bale out at low altitude after his aircraft had hit another during a victory flypast over Bremerhaven. By the end of the war, festooned with medals, he was a national hero and, in the eyes of de Gaulle, just the sort of fellow to represent the new France. He therefore became a Gaullist member of parliament, serving five different constituencies consecutively over 23 years. His books were acclaimed, he became an ardent deep-sea fisherman and there were jobs in aircraft companies and other directorships too. But nothing seems to have been quite as much fun as the war. For Mr Clostermann, if not for the French generally, it was a good one.

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Overview

Apr 6th 2006
From The Economist print edition

In another good week for **global stockmarkets**, share prices in Australia, Canada and Spain hit record highs. Many other markets, including Japan, France and Germany hit new highs for the year.

Bond yields edged higher in **America**, with ten-year Treasury bonds hitting 4.9%, up from 4.4% at the start of the year. Interest rates on 30-year fixed-rate mortgages rose to 6.5%, up from less than 5.5% in June 2005 and the highest for nearly four years. The **dollar** hit a two-month low of $1.23 against the euro.

The **euro area's** jobless rate fell to 8.2% in February, down from 8.8% a year earlier and its lowest rate for four years. However, in the same month retail sales dropped by 0.2%, leaving spending only 1.0% higher than a year ago.

In **Japan** consumer prices rose by 0.5% in the year to February, more evidence that deflation has come to an end. A year ago prices were falling at an annual rate of 0.3%. The unemployment rate fell to 4.1% in February, from 4.5% a month earlier. This was the biggest monthly drop on record and left unemployment at its lowest level since July 1998.

Britain's industrial production fell by 1.4% in the year to February.

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Output, demand and jobs

Apr 6th 2006
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	latest	qtr*	2006	2007	latest	latest	latest	year ago
Australia	+ 2.7 Q4	+ 1.9	+ 3.1	+ 3.4	+ 1.3 Q3	+ 1.9 Q4	5.0 Mar	5.2
Austria	+ 2.1 Q4	+ 2.8	+ 2.2	+ 1.9	+ 8.2 Jan	+ 4.5 Jan	5.0 Mar	5.1
Belgium	+ 1.5 Q4	+ 2.4	+ 2.2	+ 1.8	+ 2.7 Jan	– 2.5 Jan	12.4 Feb†	12.7
Britain	+ 1.8 Q4	+ 2.3	+ 2.3	+ 2.4	– 1.4 Feb	+ 2.1 Feb	5.0 Jan‡	4.7
Canada	+ 2.9 Q4	+ 2.5	+ 3.1	+ 2.8	+ 0.9 Jan	+ 4.9 Dec	6.4 Feb	7.0
Denmark	+ 3.7 Q4	+ 0.3	+ 2.8	+ 2.2	+ 1.1 Jan	+ 3.8 Feb	5.0 Feb	6.0
France	+ 1.5 Q4	+ 1.4	+ 2.0	+ 2.0	+ 0.1 Jan	+ 1.7 Feb	9.6 Feb	10.1
Germany	+ 1.0 Q4	nil	+ 1.8	+ 1.2	+ 3.2 Jan	+ 1.1 Feb	11.4 Mar§	12.1
Italy	+ 0.5 Q4	+ 0.1	+ 1.2	+ 1.1	+ 1.0 Jan	+ 0.2 Jan	7.7 Dec	7.9
Japan	+ 4.0 Q4	+ 5.4	+ 3.0	+ 2.4	+ 3.7 Feb	– 0.7 Jan	4.1 Feb	4.6
Netherlands	+ 1.6 Q4	+ 3.2	+ 2.5	+ 1.9	– 0.9 Jan	+ 7.4 Jan	6.1 Feb††	6.5
Spain	+ 3.5 Q4	+ 3.9	+ 3.1	+ 2.7	+ 2.3 Feb	+ 0.1 Feb	8.7 Feb	9.9
Sweden	+ 2.9 Q4	+ 2.6	+ 3.3	+ 2.8	+ 5.9 Jan	+ 7.7 Feb	5.6 Feb†	5.7
Switzerland	+ 2.7 Q4	+ 2.1	+ 2.3	+ 1.7	+ 3.9 Q4	+ 3.1 Jan	3.8 Feb†	4.1
United States	+ 3.2 Q4	+ 1.7	+ 3.3	+ 2.8	+ 3.3 Feb	+ 5.1 Feb	4.8 Feb	5.4
Euro area	+ 1.7 Q4	+ 1.2	+ 2.1	+ 1.7	+ 2.5 Jan	+ 1.0 Feb	8.2 Feb	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 2.9 Q4	+ 3.7	na	na	+ 3.5 Feb	+ 5.8 Jan	8.1 Feb	9.0
Greece	+ 3.7 Q4	na	na	na	+ 1.5 Jan	+ 0.5 Jan	9.7 Q4	10.4
Iceland	+ 3.6 Q4	na	na	na	na	na	1.6 Jan†	3.0
Ireland	+ 5.7 Q4	+ 7.6	na	na	+ 9.9 Jan	+ 9.0 Jan	4.5 Feb	4.3
Luxembourg	+ 3.1 Q1	na	na	na	+12.7 Jan	+ 9.1 Feb	4.8 Jan	4.3
New Zealand	+ 1.9 Q4	nil	na	na	– 2.7 Q3	+ 3.0 Q4	3.6 Q4	3.6
Norway	+ 2.5 Q4	+ 1.0	na	na	+ 3.8 Jan	+ 2.8 Feb	4.2 Jan**	4.5
Portugal	+ 0.7 Q4	+ 0.4	na	na	– 1.5 Feb	+ 3.0 Feb	8.0 Q4†	7.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Nov-Jan; claimant count rate 2.9% in Feb.
§EU harmonised rate 9.1% in Jan. ††Dec-Feb. **Nov-Jan.

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Prices and wages

Apr 6th 2006
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 2.8	Q4	+ 2.6	+ 2.8	+ 2.7	+ 4.8	Q4	+ 8.2	+ 5.3	Q4	+ 2.9
Austria	+ 1.2	Feb	+ 3.2	+ 1.9	+ 1.8	+ 1.8	Feb	+ 4.6	+ 2.7	Feb	+ 2.1
Belgium	+ 1.7	Mar	+ 3.1	+ 2.1	+ 1.8	+ 3.7	Feb	+ 4.3	+ 2.3	Oct	+ 2.4
Britain	+ 2.0	Feb*	+ 1.6	+ 2.0	+ 1.9	+ 2.9	Feb	+ 2.7	+ 3.5	Jan†	+ 4.2
Canada	+ 2.2	Feb	+ 2.1	+ 2.1	+ 2.1	+ 0.6	Feb	+ 2.8	+ 0.6	Jan	+ 2.0
Denmark	+ 2.1	Feb	+ 1.3	+ 1.9	+ 2.0	+ 4.3	Feb	+ 3.5	+ 2.9	Q4	+ 2.9
France	+ 1.9	Feb	+ 1.6	+ 1.7	+ 1.5	+ 3.5	Feb	+ 3.1	+ 3.3	Q4	+ 3.0
Germany	+ 1.9	Mar	+ 1.8	+ 1.6	+ 2.3	+ 2.9	Feb	+ 3.8	+ 1.1	Jan	+ 1.1
Italy	+ 2.1	Mar	+ 1.9	+ 2.1	+ 1.9	+ 4.9	Feb	+ 4.7	+ 2.6	Feb	+ 3.4
Japan	+ 0.5	Feb	– 0.3	+ 0.4	+ 0.6	+ 2.9	Feb	+ 1.3	+ 0.4	Feb	+ 0.1
Netherlands	+ 1.1	Feb	+ 1.6	+ 1.6	+ 1.5	+ 5.6	Feb	+ 5.2	+ 1.6	Feb	+ 0.6
Spain	+ 4.0	Feb	+ 3.3	+ 3.5	+ 2.8	+ 6.3	Feb	+ 4.9	+ 2.5	Q4	+ 2.7
Sweden	+ 0.6	Feb	+ 0.7	+ 1.2	+ 1.8	+ 4.9	Feb	+ 2.8	+ 3.4	Dec	+ 2.0
Switzerland	+ 1.0	Mar	+ 1.4	+ 1.2	+ 1.2	+ 1.5	Feb	+ 1.7	+ 0.9	2004	+ 1.4
United States	+ 3.6	Feb	+ 3.0	+ 3.0	+ 2.3	+ 3.7	Feb	+ 4.5	+ 3.5	Feb	+ 2.6
Euro area	+ 2.2	Mar	+ 2.1	+ 2.0	+ 2.0	+ 5.4	Feb	+ 4.2	+ 2.4	Q4	+ 2.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.9	Feb	+ 0.2	na	na	+ 5.3	Feb	+ 2.2	+ 3.5	Q4	+ 4.3
Greece	+ 3.2	Feb	+ 3.1	na	na	+ 8.9	Feb	+ 4.1	na		na
Iceland	+ 4.5	Mar	+ 4.7	na	na	+ 4.2	Mar	+ 7.0	+ 8.6	Feb	+ 6.7
Ireland	+ 3.3	Feb	+ 2.2	na	na	+ 3.3	Feb	– 0.4	+ 3.5	Q3	+ 4.7
Luxembourg	+ 3.0	Feb	+ 2.2	na	na	+ 3.3	Jan	+19.3	– 0.1	Dec	+ 0.8
New Zealand	+ 3.2	Q4	+ 2.7	na	na	+ 6.5	Q4	+ 3.4	+ 3.1	Q4	+ 2.5
Norway	+ 2.6	Feb	+ 1.0	na	na	+21.0	Feb	+14.4	+ 3.1	Q4	+ 3.9
Portugal	+ 2.8	Feb	+ 2.2	na	na	+ 5.9	Feb	+ 4.0	+ 0.2	Jan	– 1.5

*RPI inflation rate 2.4% in Feb. †Nov-Jan.

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Economic forecasts

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From The Economist print edition

The Economist poll of forecasters, April averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2006	2007	2006	2007	2006	2007	2006	2007
Australia	2.8/3.7	2.7/3.8	3.1	3.4 (3.3)	2.8 (2.9)	2.7	-5.5(-5.4)	-5.0 (-4.0)
Austria	2.0/2.4	1.5/2.2	2.2 (2.1)	1.9	1.9 (2.0)	1.8	0.1 (0.2)	0.1 (0.2)
Belgium	2.0/2.5	1.6/2.2	2.2 (2.1)	1.8 (1.9)	2.1 (2.2)	1.8 (1.9)	2.0 (2.2)	2.1 (2.3)
Britain	1.9/2.6	1.9/2.8	2.3 (2.1)	2.4 (2.5)	2.0 (1.9)	1.9	-2.5(-2.3)	-2.5 (-2.3)
Canada	2.7/3.5	2.6/3.1	3.1	2.8	2.1	2.1 (2.2)	2.2 (2.0)	1.6 (1.4)
Denmark	2.5/3.3	1.7/3.1	2.8	2.2 (2.3)	1.9	2.0 (1.9)	2.7 (2.9)	2.5 (2.7)
France	1.5/2.2	1.6/2.4	2.0 (1.9)	2.0	1.7	1.5 (1.6)	-1.6(-1.3)	-1.3 (-1.1)
Germany	1.5/2.2	0.3/1.9	1.8	1.2	1.6	2.3	3.9	4.1 (3.9)
Italy	0.9/1.5	0.6/1.6	1.2 (1.3)	1.1 (1.2)	2.1	1.9	-1.5	-1.4
Japan	2.5/3.7	1.5/3.9	3.0 (2.9)	2.4	0.4 (0.3)	0.6	3.7	3.6 (3.5)
Netherlands	1.7/3.1	1.4/2.7	2.5 (2.2)	1.9	1.6 (1.5)	1.5	5.7 (5.2)	5.6 (5.1)
Spain	2.8/3.5	2.4/3.1	3.1	2.7	3.5 (3.3)	2.8	-7.3(-6.9)	-7.4 (-7.0)
Sweden	2.9/4.1	2.5/3.1	3.3	2.8	1.2 (1.4)	1.8 (1.9)	6.5 (6.7)	6.1 (6.3)
Switzerland	2.0/2.8	1.1/2.5	2.3 (2.2)	1.7	1.2 (1.1)	1.2	13.0(13.1)	12.3 (12.4)
United States	2.8/3.7	2.4/3.5	3.3	2.8	3.0 (2.9)	2.3	-6.8	-6.7 (-6.8)
Euro area	1.8/2.4	1.3/2.4	2.1 (2.0)	1.7 (1.8)	2.0 (2.1)	2.0 (2.1)	-0.3(-0.1)	-0.1 (nil)

Sources: ABN AMRO, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, JPMorgan Chase, Morgan Stanley, Decision Economics, BNP Paribas, Royal Bank of Canada, Citigroup, Scotiabank, UBS

Every month *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances in 15 countries and the euro area. The table also shows the highest and lowest projections for growth. The previous month's figures, where they are different, are shown in brackets. The panel has raised its forecast for euro-area growth in 2006 to 2.1%, up from 2.0% in March. But it has trimmed its prediction for the following year to 1.7%, down from 1.8% last month. For both 2006 and 2007, it is forecasting euro-area inflation of 2.0% a year, compared with 2.1% in March. The panel now thinks Japan will grow this year by 3.0%, up from 2.9% a month ago. It expects Japanese inflation of 0.4% in 2006, up from 0.3% in March. American prices are forecast to rise this year by 3.0%, up from 2.9% last month.

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Money and interest rates

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From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Apr 5th 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 6.7	+ 7.5	Feb	5.62	6.74	5.39	5.45	5.56	6.48
Britain	+ 6.2	+12.2	Feb	4.58	4.89	4.40	4.37	4.68	5.12
Canada	+10.0	+ 6.4	Feb	3.90	2.52	4.04	4.33	4.34	5.37
Denmark	+20.2	+14.4	Feb	2.95	2.20	3.35	3.89	3.64	5.22
Japan	+ 5.5	+ 1.7	Feb	0.04	0.02	0.64	1.83	1.37	1.90
Sweden	+ 1.3	+ 8.8	Feb	1.99	1.97	2.96	3.72	3.63	3.65
Switzerland	+ 1.4	+ 3.8	Feb	1.26	0.78	1.71	2.55	2.23	2.44
United States	+ 0.4	+ 8.0	Feb	4.82	2.97	4.80	4.83	4.43	5.83
Euro area†	+ 9.9	+ 8.0	Feb	2.82	2.15	3.29	3.81	3.55	4.35

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.90%, Japan No. 278 1.84%. Central bank rates: US fed funds 4.75%, ECB refinancing 2.50%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity index

Apr 6th 2006
From The Economist print edition

2000=100

	Mar 28th	Apr 4th*	% change on one month	% change on one year
Dollar index				
All items	156.8	158.5	+ 2.4	+18.7
Food	133.7	134.0	– 1.9	+ 5.8
Industrials				
All	186.7	190.2	+ 6.7	+33.6
Nfa†	148.1	150.5	+ 0.8	+16.5
Metals	207.7	211.8	+ 9.2	+41.8
Sterling index				
All items	135.9	136.9	+ 1.2	+26.9
Euro index				
All items	120.0	119.5	– 0.7	+24.3
Yen index				
All items	169.9	172.8	+ 2.1	+28.6
Gold				
$ per oz	567.75	586.85	+ 6.8	+38.1
West Texas Intermediate				
$ per barrel	66.01	66.18	+ 7.6	+18.5

*Provisional. †Non-food agriculturals.

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Stockmarkets

Apr 6th 2006
From The Economist print edition

Market indices

		2006		% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
	Apr 5th	high	low				
Australia (All Ordinaries)	5,159.0	5,049.4	4,708.8	+ 2.2	nil	+ 9.6	+ 8.6
Austria (ATX)	4,119.3	4,158.6	3,682.4	+ 1.6	- 0.9	+12.3	+16.8
Belgium (Bel 20)	3,929.6	3,978.0	3,573.9	+ 0.4	- 1.2	+10.7	+15.2
Britain (FTSE 100)	6,044.1	6,036.3	5,618.8	+ 1.4	-12.8	+ 7.6	+ 9.6
Canada (Toronto Composite)	12,190.6	12,190.6	11,272.3	nil	nil	+ 8.1	+ 8.7
Denmark (OMXCB)	393.7	395.5	362.0	+ 1.4	- 0.5	+ 7.0	+11.3
France (SBF 250)	3,689.6	3,679.2	3,327.6	+ 0.9	-16.0	+11.8	+16.3
(CAC 40)	5,221.0	5,218.7	4,748.3	+ 0.8	-24.6	+10.7	+15.2
Germany (DAX)*	6,029.2	5,973.1	5,334.3	+ 1.9	-25.2	+11.5	+16.0
Italy (S&P/MIB)	38,440.0	38,602.0	35,652.0	+ 2.0	-23.3	+ 7.7	+12.0
Japan (Nikkei 225)	17,244.0	16,938.4	15,341.2	+ 1.8	-55.7	+ 7.0	+ 7.4
(Topix)	1,746.1	1,713.5	1,572.1	+ 2.0	-39.5	+ 5.8	+ 6.2
Netherlands (AEX)	468.5	472.1	431.5	- 0.1	-33.2	+ 7.3	+11.6
Spain (Madrid SE)	1,296.0	1,294.9	1,156.8	+ 1.0	nil	+12.1	+16.6
Sweden (Affarsvarlden Gen)	333.0	328.2	287.3	+ 1.5	-16.8	+13.5	+18.4
Switzerland (Swiss Market)	8,090.5	8,064.0	7,583.9	+ 1.3	- 3.8	+ 6.7	+ 9.3
United States (DJIA)	11,215.7	11,317.4	10,667.4	nil	- 4.3	+ 4.6	+ 4.6
(S&P 500)	1,302.9	1,307.3	1,248.3	nil	-14.7	+ 4.4	+ 4.4
(NASDAQ Comp)	2,337.8	2,337.8	2,205.3	nil	-53.7	+ 6.0	+ 6.0
Europe (FTSEurofirst 300)†	1,379.1	1,383.2	1,277.1	+ 0.8	-19.1	+ 8.1	+12.5
Euro area (FTSE Euro 100)†	1,189.2	1,190.6	1,078.9	+ 1.0	-23.3	+ 9.2	+13.6
World (MSCI)‡	1,332.3	1,340.1	1,259.1	nil	- 8.0	+ 5.9	+ 5.9
World bond market (Citigroup)††	615.6	638.9	613.5	nil	- 3.7	- 0.8	- 0.8

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Apr 6th 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current-account balance $bn latest 12 mths	Current-account balance The Economist poll % of GDP, forecast 2006	Current-account balance The Economist poll % of GDP, forecast 2007	Exchange rate trade-weighted† 2000=100 Apr 5th	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Apr 5th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2005‡
Australia	− 12.8 Feb	− 42.1 Q4	− 5.5	− 5.0	115.7	115.3	1.38	1.31	2.41	1.69	1.17	+ 1.0
Austria	− 1.9 Jan	+ 0.5 Dec	+ 0.1	+ 0.1	104.9§	105.9	0.82	0.78	1.43	–	0.69	− 2.0
Belgium	+ 12.9 Jan	+ 6.6 Dec	+ 2.0	+ 2.1	106.6§	107.9	0.82	0.78	1.43	–	0.69	nil
Britain	−119.4 Jan	− 57.4 Q4	− 2.5	− 2.5	96.6	100.6	0.57	0.53	–	0.70	0.49	− 3.1
Canada	+ 57.8 Jan	+ 25.2 Q4	+ 2.2	+ 1.6	124.8	117.2	1.16	1.22	2.03	1.43	0.99	+ 1.3
Denmark	+ 9.4 Jan	+ 7.4 Jan	+ 2.7	+ 2.5	106.5	106.4	6.08	5.80	10.6	7.46	5.17	+ 2.8
France	− 29.2 Jan	− 39.7 Jan	− 1.6	− 1.3	107.3§	108.8	0.82	0.78	1.43	–	0.69	− 3.2
Germany	+197.8 Jan	+111.0 Jan	+ 3.9	+ 4.1	108.7§	110.4	0.82	0.78	1.43	–	0.69	− 3.9
Italy	− 14.6 Jan	− 26.5 Jan	− 1.5	− 1.4	106.9§	108.3	0.82	0.78	1.43	–	0.69	− 4.3
Japan	+ 89.0 Jan	+162.7 Jan	+ 3.7	+ 3.6	81.2	86.0	118	109	206	144	–	− 6.5
Netherlands	+ 39.0 Jan	+ 39.8 Q4	+ 5.7	+ 5.6	107.4§	108.7	0.82	0.78	1.43	–	0.69	− 1.6
Spain	− 97.6 Jan	− 85.5 Dec	− 7.3	− 7.4	105.2§	106.1	0.82	0.78	1.43	–	0.69	+ 0.3
Sweden	+ 19.2 Feb	+ 21.8 Q4	+ 6.5	+ 6.1	96.7	99.1	7.63	7.13	13.3	9.36	6.48	+ 1.2
Switzerland	+ 7.0 Feb	+ 50.2 Q4	+13.0	+12.3	105.4	107.3	1.29	1.21	2.25	1.58	1.09	− 1.6
United States	−792.6 Jan	−804.9 Q4	− 6.8	− 6.7	86.3	83.4	–	–	1.75	1.23	0.85	− 3.7
Euro area	+ 18.1 Jan	− 40.3 Jan	− 0.3	− 0.1	118.4	118.1	0.82	0.78	1.43	–	0.69	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 10.4 Jan	+ 5.3 Jan	na	na	108.1§	109.4	0.82	0.78	1.43	–	0.69	+ 2.1
Greece	− 34.5 Jan	− 18.1 Jan	na	na	103.6§	105.1	0.82	0.78	1.43	–	0.69	− 4.5
Iceland	− 1.6 Feb	− 2.6 Q4	na	na	106.8**	95.0	72.8	61.2	127	89.3	61.9	+ 2.0
Ireland	+ 39.6 Jan	− 3.9 Q4	na	na	112.1§	114.7	0.82	0.78	1.43	–	0.69	− 0.9
Luxembourg	− 4.9 Jan	+ 3.6 Q4	na	na	106.6§	107.9	0.82	0.78	1.43	–	0.69	− 2.3
New Zealand	− 5.0 Feb	− 9.6 Q4	na	na	123.3	136.3	1.63	1.41	2.85	2.00	1.39	+ 5.3
Norway	+ 50.6 Feb	+ 49.5 Q4	na	na	111.3	107.3	6.45	6.36	11.3	7.91	5.48	+ 15.3
Portugal	− 23.0 Dec	− 16.6 Jan	na	na	104.6**	104.3	0.82	0.78	1.43	–	0.69	− 6.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, January average. ‡OECD estimate.
**IMF, November average.

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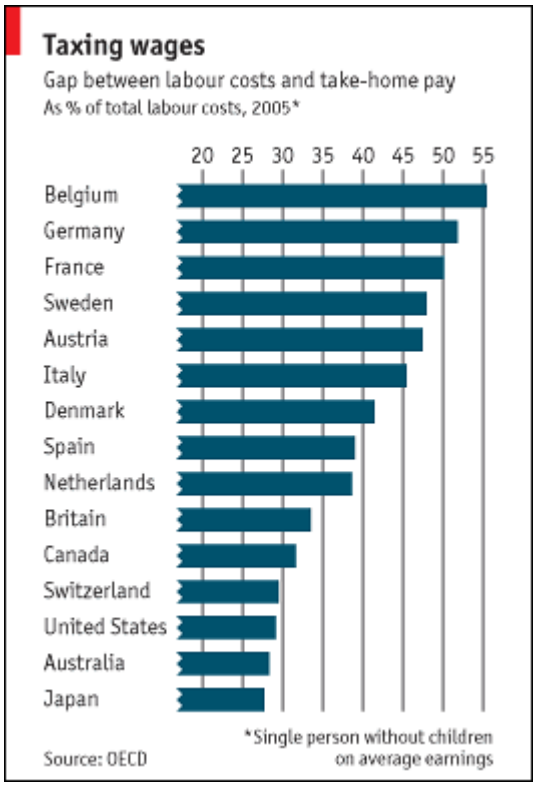
Taxing wages

Apr 6th 2006
From The Economist print edition



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Overview

Apr 6th 2006
From The Economist print edition

Turkey's GDP growth climbed to 9.5% in the year to the fourth quarter. Its consumer prices rose by 8.2% in the year to March and its trade deficit widened to $3.9 billion in February, up 46% from a year earlier.

Brazil's industrial output expanded by 5.4% in the year to February.

Colombia's GDP grew by 3.7% in the year to the fourth quarter, down from 6.4% in the year to the third quarter.

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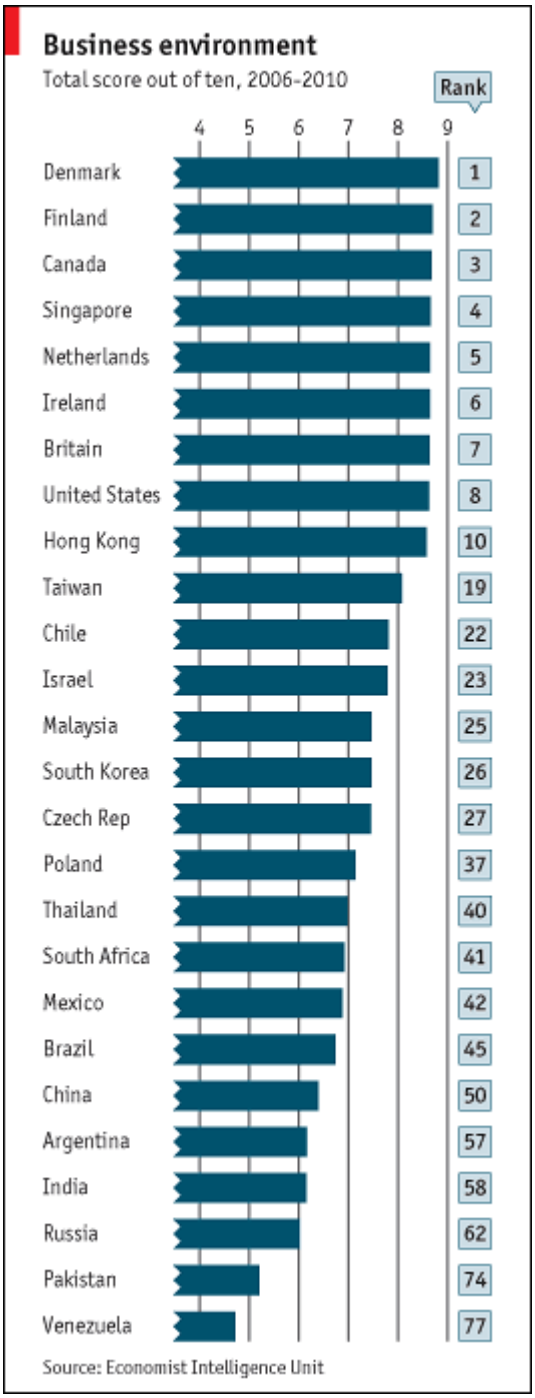
Business environment

Apr 6th 2006
From The Economist print edition

Despite all the foreign-direct investment it attracts, China is not an easy place to do business, coming 50th out of 82 economies ranked by the Economist Intelligence Unit (EIU), a sister company of *The Economist*. Poland, having secured entry to the European Union, has lost the appetite for business-friendly reforms, the EIU says, and now languishes in 37th place.



Economy

Apr 6th 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q4	+16.2	Feb	+ 0.9	Feb	+102.6	Feb	+128.5	H1	853.7	Feb
Hong Kong	+ 7.6	Q4	+ 5.9	Q4	+ 1.6	Feb	−11.3	Feb	+19.7	Q4	125.7	Feb
India	+ 7.6	Q4	+ 8.3	Jan	+ 4.4	Jan	−38.0	Feb	−13.3	Q4	136.6	Feb
Indonesia	+ 4.9	Q4	−15.4	Jan	+15.7	Mar	+29.8	Feb	+ 3.0	Q4	33.3	Jan
Malaysia	+ 5.2	Q4	+ 2.6	Jan	+ 3.2	Feb	+26.8	Feb	+19.9	Q4	71.6	Feb
Pakistan	+ 8.4	2005†	+19.3	Sep	+ 8.0	Feb	−10.1	Feb	− 3.7	Q4	9.8	Jan
Philippines	+ 6.1	Q4	− 2.8	Jan	+ 7.6	Mar	− 3.8	Jan	+ 2.4	Dec	18.0	Feb
Singapore	+ 8.7	Q4	+37.2	Feb	+ 1.2	Feb	+30.6	Feb	+33.2	Q4	120.2	Feb
South Korea	+ 5.3	Q4	+20.0	Feb	+ 2.0	Mar	+19.3	Feb	+11.1	Feb	217.3	Mar
Taiwan	+ 6.4	Q4	+14.1	Feb	+ 1.0	Feb	+ 7.6	Feb	+16.4	Q4	257.1	Mar
Thailand	+ 4.7	Q4	+12.8	Feb	+ 5.7	Mar	− 7.0	Feb	− 1.8	Feb	52.9	Feb
Argentina	+ 9.1	Q4	+ 8.6	Feb	+11.1	Mar	+11.3	Feb	+ 5.4	Q4	18.7	Jan
Brazil	+ 1.4	Q4	+ 5.4	Feb	+ 5.5	Feb	+45.8	Mar	+13.5	Feb	56.3	Jan
Chile	+ 5.8	Q4	+ 5.0	Feb	+ 4.0	Mar	+ 9.7	Feb	+ 0.7	Q4	16.1	Feb
Colombia	+ 3.7	Q4	+ 5.9	Jan	+ 4.2	Feb	+ 1.4	Jan	− 1.9	Q4	14.9	Feb
Mexico	+ 2.7	Q4	+ 6.0	Jan	+ 3.7	Feb	− 4.9	Feb	− 5.7	Q4	76.7	Jan
Peru	+ 4.4	Jan	+ 4.1	Jan	+ 2.5	Mar	+ 5.2	Jan	+ 1.0	Q4	13.0	Feb
Venezuela	+10.2	Q4	+13.5	Dec	+12.1	Mar	+31.5	Q4	+25.4	Q4	23.9	Dec
Egypt	+ 5.2	Q1	+ 4.0	2005†	+ 3.4	Jan	−11.1	Q4	+ 1.8	Q3	21.3	Feb
Israel	+ 4.8	Q4	+ 8.4	Jan	+ 3.1	Feb	− 8.7	Feb	+ 2.4	Q4	28.0	Feb
Saudi Arabia	+ 6.5	2005‡	na		+ 1.5	Jan	+84.6	2004	+51.9	2004	26.0	Jan
South Africa	+ 4.5	Q4	+ 5.6	Jan	+ 3.9	Feb	− 4.7	Feb	−10.1	Q4	20.2	Feb
Czech Republic	+ 6.9	Q4	+15.1	Jan	+ 2.8	Feb	+ 1.7	Feb	− 2.6	Q4	29.4	Feb
Hungary	+ 4.3	Q4	+11.6	Feb	+ 2.5	Feb	− 3.3	Jan	− 8.0	Q4	19.8	Feb
Poland	+ 4.2	Q4	+10.1	Feb	+ 0.7	Feb	− 2.9	Jan	− 4.5	Jan	43.7	Feb
Russia	+ 7.0	Q4	+ 1.0	Feb	+10.6	Mar	+124.3	Jan	+84.3	Q1	205.9	Mar
Turkey	+ 9.5	Q4	− 4.5	Jan	+ 8.2	Mar	−45.3	Feb	−23.4	Jan	56.5	Feb
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+11.1	Q4	+ 5.2	Feb	+ 4.6	Feb	− 2.6	Jan	− 1.3	Jan	1.9	Jan
Latvia	+10.5	Q4	+11.2	Jan	+ 6.1	Feb	− 3.0	Jan	− 2.0	Jan	2.3	Jan
Lithuania	+ 8.8	Q4	na		+ 3.4	Feb	− 3.8	Jan	− 1.9	Jan	4.0	Jan
Slovakia	+ 7.6	Q4	+ 7.7	Jan	+ 4.4	Feb	− 2.7	Jan	− 4.0	Dec	15.1	Jan
Slovenia	+ 5.1	Q4	+ 6.6	Jan	+ 1.9	Mar	− 1.7	Jan	− 0.2	Jan	8.1	Dec

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Apr 6th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Apr 5th		Dec 30th 2005	
	Apr 5th	year ago	Apr 5th	% a year		one week	in local currency	in $ terms
China	8.01	8.28	14.0	2.40	1,404.9	+2.6	+ 15.1	+ 16.0
Hong Kong	7.76	7.80	13.6	4.61	16,100.1	+2.3	+ 8.2	+ 8.1
India	44.6	43.7	78.1	6.09	11,746.9	+5.0	+ 25.0	+ 26.1
Indonesia	9,015	9,480	15,769	13.65	1,344.6	+1.6	+ 15.7	+ 26.2
Malaysia	3.67	3.80	6.42	3.51	941.7	+0.9	+ 4.7	+ 7.7
Pakistan	60.1	59.4	105	9.09	11,666.4	+2.2	+ 22.1	+ 21.4
Philippines	51.1	54.7	89.4	7.50	2,197.9	+0.7	+ 4.9	+ 8.8
Singapore	1.61	1.66	2.81	3.44	2,544.9	+1.0	+ 8.4	+ 12.1
South Korea	957	1,014	1,675	4.29	1,388.8	+4.2	+ 0.7	+ 6.3
Taiwan	32.5	31.6	56.8	1.70	6,665.6	+2.6	+ 1.8	+ 3.0
Thailand	38.2	39.6	66.8	5.10	768.1	+6.0	+ 7.6	+ 15.5
Argentina	3.08	2.91	5.39	9.69	1,803.9	nil	+ 16.9	+ 14.8
Brazil	2.14	2.60	3.74	16.54	37,491.0	nil	+ 12.1	+ 22.5
Chile	522	585	913	4.68	9,930.9	nil	+ 7.9	+ 5.9
Colombia	2,297	2,363	4,018	5.99	11,149.6	nil	+ 17.2	+ 16.7
Mexico	11.0	11.2	19.2	7.22	19,132.3	nil	+ 7.5	+ 4.4
Peru	3.37	3.26	5.90	4.77	5,943.8	nil	+ 23.8	+ 25.9
Venezuela	2,495§	2,763§	4,365	10.19	29,692.0	nil	+ 45.6	+ 50.9
Egypt	5.74	5.80	10.04	8.61	59,106.7	+1.3	+ 6.8	+ 6.7
Israel	4.61	4.37	8.06	5.28	859.6	+1.7	+ 3.8	+ 3.7
Saudi Arabia	3.75	3.75	6.56	5.04	17,665.1	+3.5	+ 5.7	+ 5.7
South Africa	6.03	6.15	10.5	7.20	20,685.3	+1.8	+ 14.3	+ 20.3
Czech Republic	23.2	23.3	40.7	2.09	1,538.7	+1.5	+ 4.5	+ 10.7
Hungary	217	192	380	6.27	22,924.2	+0.4	+ 10.3	+ 8.6
Poland	3.24	3.20	5.67	4.17	40,826.0	+3.0	+ 14.7	+ 15.3
Russia	27.5	27.9	48.2	12.00	1,485.2‡	+6.7	+ 26.4	+ 31.9
Turkey	1.33	1.35	2.33	14.23	44,088.6	+3.7	+ 10.8	+ 12.3
EM (MSCI)*	1.00	1.00	1.75	na	772.3	nil	+ 9.3	+ 9.3
EMBI+†	1.00	1.00	1.75	na	375.0	nil	+ 1.7	+ 1.7

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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